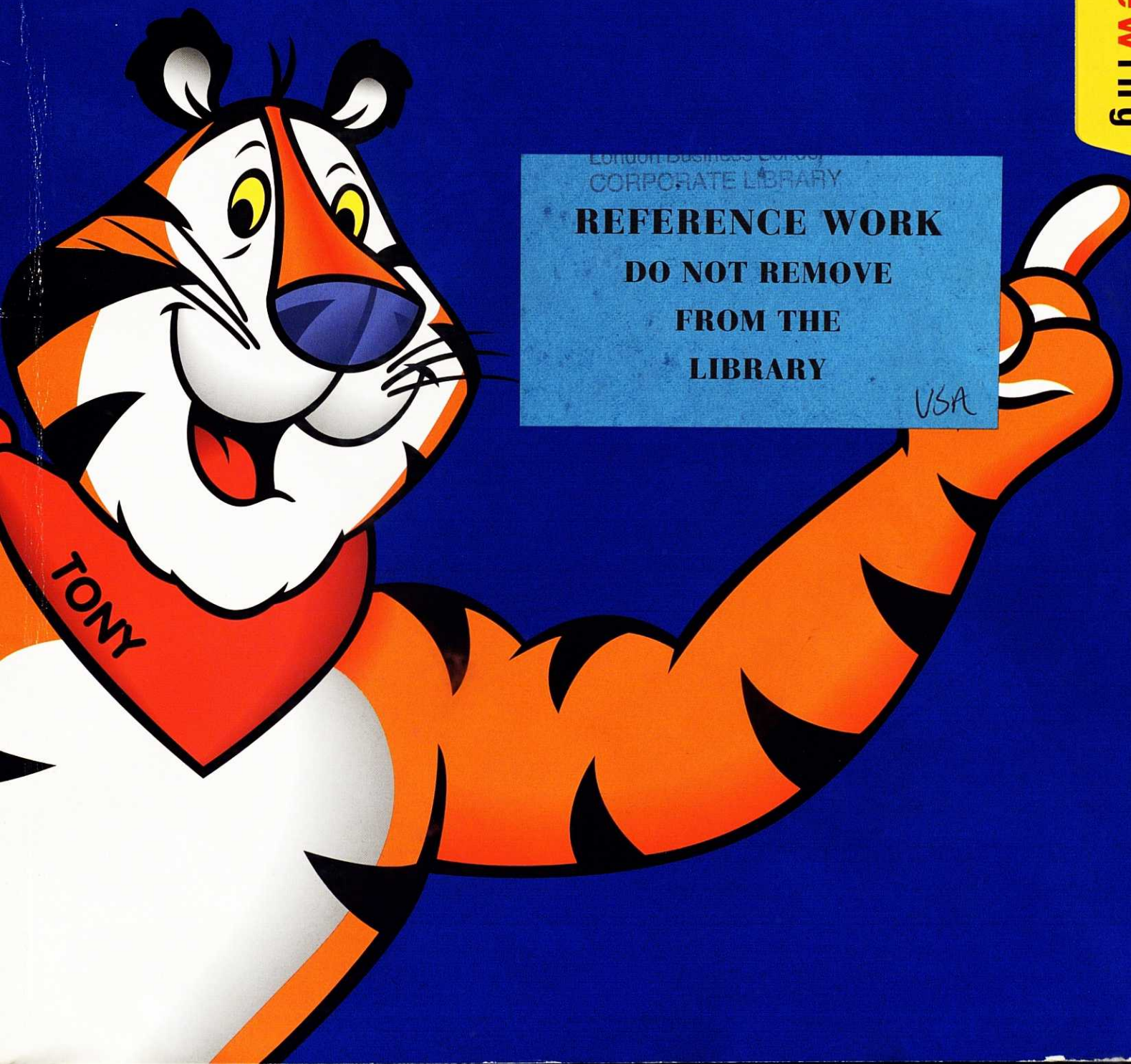


Kellogg Company

Annual Report

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1999
Winning

With sales of nearly \$7 billion, Kellogg Company is the world's leading producer of ready-to-eat cereal and a leading producer of convenience foods, including toaster pastries, cereal bars, frozen waffles, and meat alternatives. The Company's brands include *Kellogg's*®, *Special K*®, *Rice Krispies*®, *Eggo*®, *Pop-Tarts*®, *Nutri-Grain*®, and *Morningstar Farms*®. Kellogg icons such as *Tony the Tiger*® and *Snap!*®, *Crackle!*®, *Pop!*® are among the most recognized characters in advertising. Kellogg products are manufactured in 20 countries and marketed in more than 160 countries around the world.

FINANCIAL HIGHLIGHTS

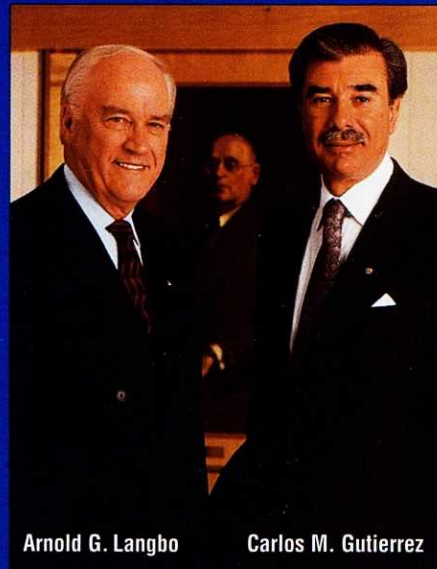
(millions, except per share data)	1999	Change	1998	Change	1997	Change
Net sales	\$6,984.2	+3%	\$6,762.1	-1%	\$6,830.1	+2%
Operating profit, excluding charges (a)	1,073.4	+11%	965.6	-19%	1,193.2	+9%
Net earnings, excluding charges and before cumulative effect of accounting change (a) (b)	606.2	+10%	548.9	-22%	704.5	+8%
Net earnings per share (basic and diluted), excluding charges and before cumulative effect of accounting change (a) (b)	1.50	+11%	1.35	-21%	1.70	+11%
Operating profit	828.8	-7%	895.1	-11%	1,009.1	+5%
Net earnings	338.3	-33%	502.6	-8%	546.0	+3%
Net earnings per share (basic and diluted)	.83	-33%	1.23	-7%	1.32	+6%
Net cash provided by operating activities	795.2	+10%	719.7	-18%	879.8	+24%
Capital expenditures	266.2	-29%	373.9	+20%	312.4	+2%
Average shares outstanding	405.2		407.8		414.1	
Dividends per share	\$.96	+4%	\$.92	+6%	\$.87	+7%

(a) Refer to Management's Discussion and Analysis on pages 13-19 and Note 3 within Notes to Consolidated Financial Statements for further explanation of restructuring charges and asset impairment losses for years 1997-1999.

(b) Refer to Management's Discussion and Analysis on pages 13-19 and Note 2 within Notes to Consolidated Financial Statements for further explanation of disposition-related charges in 1999. Refer to Management's Discussion and Analysis on pages 13-19 and Note 1 within Notes to Consolidated Financial Statements for further explanation of cumulative effect of accounting change in 1997.

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TO OUR SHARE OWNERS

In 1999, we began a process of renewal designed to strengthen significantly the ability of Kellogg Company to compete and prosper in the 21st century. We believe our mission of producing great-tasting products which are healthier than alternatives places us in the enviable position of being in line with consumer trends all around the world.

renewing

Kellogg's®

While we took many significant steps to strengthen our Company during 1999, the value of our stock, including reinvested dividends, declined by 7.2 percent. In part, this decline reflects an overall weakness in food stocks. Nonetheless, this provides little consolation for a leadership team determined to deliver superior results. We believe our stock price is a powerful sign that investors are waiting for Kellogg to show consistent, high-quality growth after several volatile years. This is exactly what we plan to do.

1999 was a good start. We recorded 11 percent increases in both operating profit and earnings per share (excluding charges) on a 3.3 percent increase in net sales.



Excluding the impact of foreign exchange, net sales grew 4.6 percent, one of the highest rates of growth in the food industry. Sales increased for both cereal and convenience foods. Cereal sales were up by nearly 1 percent and convenience foods sales by more than 12 percent. Our five-year compound growth rate for convenience foods sales is more than 16 percent.

We expanded our profit margins, and operating profit (excluding charges) rose in each of our four geographic operating areas, with increases of 4 percent in North America, 6 percent in Europe, 10 percent in Asia-Pacific, and 32 percent in Latin America.

Our free cash flow (net cash provided by operating activities less capital expenditures) grew by over 50 percent and we increased dividends for the 43rd consecutive year, with a per share increase to \$.96 from \$.92.



Significantly, our growth in 1999 was accomplished while taking major actions to renew our Company:

- Eight of our top 10 executives are new in their jobs and four of our most important positions are occupied by top-caliber executives who joined our Company during 1999 and early 2000: John D. Cook, formerly a partner with McKinsey and Company, as executive vice president and president, Kellogg North America; Jacobus "Koos" Groot, formerly with Procter and Gamble Company, as executive vice president and president, Kellogg Asia-Pacific; Janet L. Kelly, from Sara Lee Corporation, as executive vice president - corporate development, general counsel, and secretary; and, in January 2000, Thomas J. Webb, from Ford Motor Company, as executive vice president and chief financial officer.

We promoted Alan F. Harris from executive vice president and president, Kellogg Latin America to executive vice president and president, Kellogg Europe; Gustavo Martinez from general manager, Kellogg de Mexico S.A. de C.V. to vice president and president, Kellogg Latin America; and James W. Larson to vice president - human resources. Other promotions included Stephen C. Benoit to vice president, Jeffrey M. Boromisa to vice president and corporate controller, and Harold G. Gobble to vice president - product development.

- We re-focused our important ready-to-eat cereal business, particularly in the United States, United Kingdom, Canada, and Australia. Despite late-1999 softness in the U.S., we are confident about our growth prospects in 2000 and beyond. In the United Kingdom, the cereal category returned to growth in the second half of 1999. Canada and Australia both showed strong performances in volume and profitability.

- We invested significantly to grow our emerging and developing markets in Asia, Latin America, and Europe. Our investments paid off handsomely; we achieved double-digit sales and operating profit growth in many of these markets and, most encouragingly, we see many years of strong growth to come.

Leadership in Ready-to-Eat Cereal Volume Around the World*

Market	Kellogg Share (percentage)	Kellogg Ranking
North America		
Canada	44	1
United States	31	1
Europe		
Austria	34	1
Belgium	57	1
Denmark	51	1
Finland	37	1
France	42	1
Germany	33	1
Great Britain	39	1
Ireland	60	1
Italy	63	1
Norway	39	1
Portugal	30	2
South Africa	43	1
Spain	61	1
Sweden	41	1
Asia-Pacific		
Australia	46	1
India	63	1
Japan	47	1
Malaysia	30	2
New Zealand	20	2
South Korea	49	1
Taiwan	72	1
Latin America		
Argentina	43	1
Brazil	51	1
Chile	28	2
Mexico	65	1
Puerto Rico	42	1

* Based on most recent 12-month volume share data available as of January 31, 2000.

- We strengthened our convenience foods business with 10 new product innovations in the United States, the continued development of new distribution channels, and international expansion. These products are great-tasting, convenient, and, true to our mission, healthier than alternatives. They are backed by strong, well-known brands and are a key element of our growth strategy.
- We divested Lender's Bagels, a low-growth, resource-intensive business, and acquired Worthington Foods, Inc. Worthington is the leading manufacturer and marketer of meat alternatives. Kellogg and Worthington share strong traditions of commitment to nutrition and wellness. This fine company will become an important new growth stream for us.
- We achieved \$180 million of cost savings in 1999. This included difficult but necessary decisions to

downsize our workforce in our corporate headquarters and in our North American, European, and Latin American organizations. Additional savings, beginning in 2000, will be generated by our 1999 decision to close the South Operations portion of our Battle Creek cereal plant.

Not everything needs to be renewed. We own some of the world's most valued and trusted brands; we have world-class product innovation capabilities; we have strong relations with customers around the world and a highly efficient supply chain infrastructure that serves more than 160 countries. We are determined to combine these assets with the skills and commitment of Kellogg people all around the world to build value for you.

We are starting from a strong foundation, with leadership in every major category in which we compete.



Category Leadership by Kellogg*

Category	Kellogg Share (percentage)	Kellogg Ranking	Margin of Leadership (in shares)
Ready-to-eat cereal (global)	37	1	18
Ready-to-eat cereal (U.S.)	31	1	4
Toaster pastries (U.S.)	72	1	51
Frozen waffles (U.S.)	58	1	37
Cereal bars (U.S.)	25	1	4
Meat alternatives (U.S.)	38	1	21

*Based on most recent 12-month volume share data available as of January 31, 2000.

- In ready-to-eat cereal, we are the global leader with a category share nearly double that of our nearest competitor and with leadership in the vast majority of markets where we compete (for data, see chart on page 3).
- In the U.S. market, besides being first in cereal volume share, we are first in toaster pastries with the *Kellogg's Pop-Tarts®* brand, first in frozen waffles with the *Eggo®* brand, first in cereal bars with the *Nutri-Grain®* and *Rice Krispies Treats®* brands, and first in meat alternatives with the *Morningstar Farms®* brand (for data, see category leadership chart above).

We are proud of our leadership positions and are determined to strengthen those positions throughout our global business.

Recognition and Board Appointment

We extend our appreciation to Donald W. Thomason, who retired during 1999 as executive vice president - services and technology after a distinguished 36-year career with Kellogg Company.

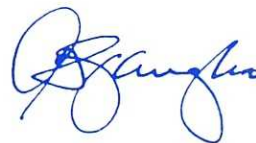
In December 1999, William D. Perez, president and chief executive officer of S.C. Johnson & Son, Inc., was

elected to our Board of Directors. He joins a group of dedicated directors who are committed to the renewal of Kellogg Company. Their experience and wisdom are focused exclusively on doing what is right for the long-term benefit of the share owners of our Company.

Finally, we are grateful for the Kellogg people around the world who worked diligently during a difficult year. We are all committed to the vision of a renewed, vibrant, and prosperous Kellogg Company and are inspired by the confidence you have placed in us.



Carlos M. Gutierrez
President
Chief Executive Officer



Arnold G. Langbo
Chairman of the Board

renewing Kellogg's®

Kellogg Company is generating more profitable growth by combining its best equities — both brands and characters — with its best product and promotional ideas. Kellogg's® Raisin Bran Crunch™ cereal is a prime example of this powerful combination. Here are other examples:

- Use of the powerful *Special K*® equity helped spur the 1999 launches of Kellogg's *Special K Plus*™ high-nutrition cereal in the United States and Kellogg's® *Special K*® with red berries in the United Kingdom and France, as well as the early 2000 Cindy Crawford promotion in the U.S.
- Early 2000 initiatives such as *Sesame Street*®† *Mini-Beans*™ inserts, *NASCAR*®†† *Hot-Wheels*®††† mail-in offers, and basketball-shaped *Three-Point-Pops*™ cereal are being focused on Kellogg's® favorite family and kids' brands.
- Each of Kellogg Company's "big four" convenience foods brands — *Pop-Tarts*®, *Eggo*®, *Nutri-Grain*®, and *Rice Krispies Treats*® — is being leveraged into its own family of multiple foods, including great new products such as *Eggo*® Toaster Muffins, *Rice Krispies Treats*® *Scotcheroos*™, and *Pop-Tarts Pastry Swirls*™ cream cheese and cherry flavor.



Through Brands and Ideas



renewing Kellogg's®



Through Daylong Appeal

Kellogg Company provides "the best to you each morning"™ - and all day, too! The daylong appeal of our product lineup is an important platform for sales and earnings growth in the new century. For example:

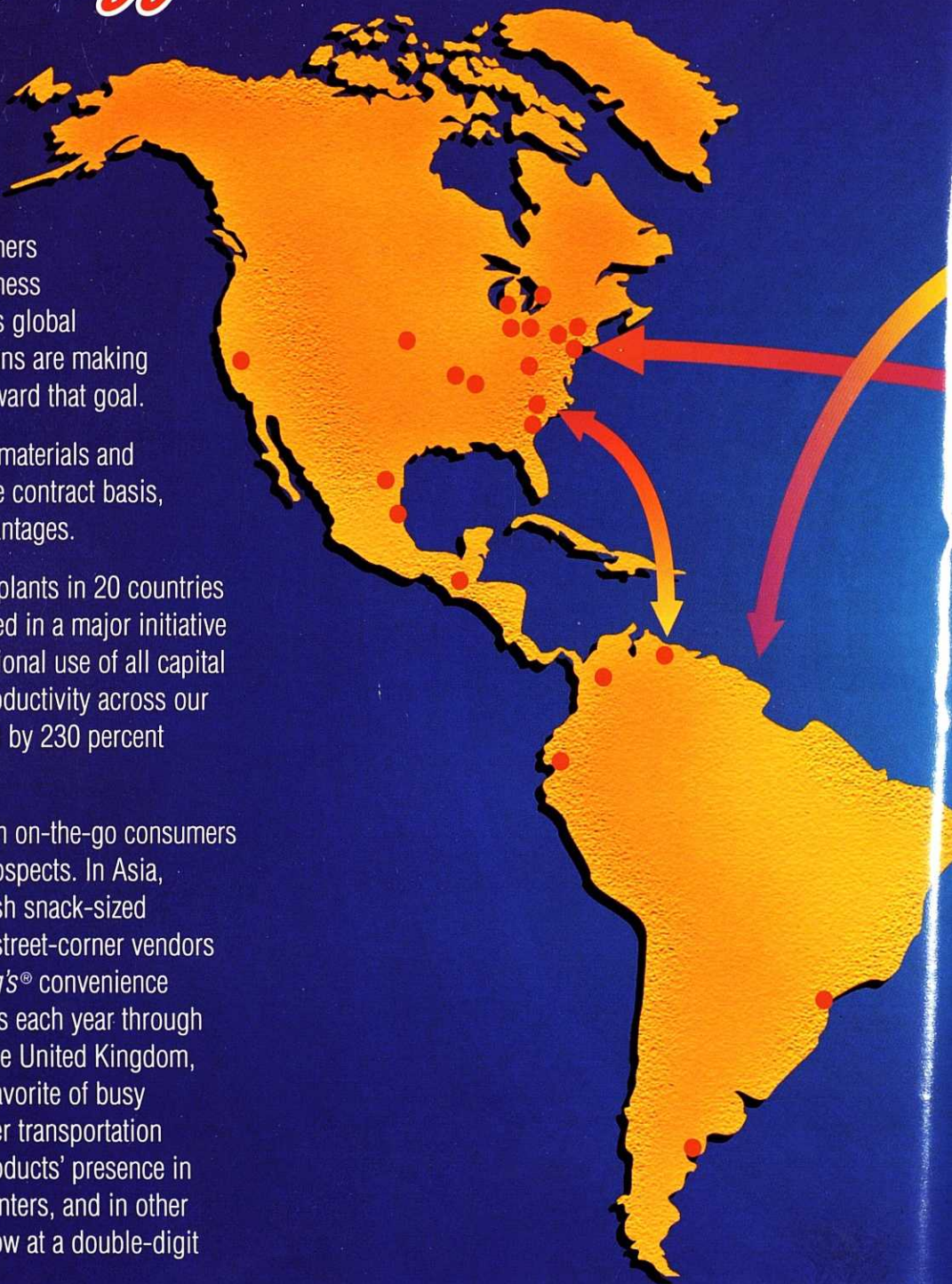
- Cereal is no longer just a breakfast food. In the United States, about 23 percent of cereal is now consumed at snacks, lunch, or dinner, and that percentage is growing every year. As the dominant leader in global cereal sales, Kellogg is well-positioned to take advantage of this opportunity.
- Great new snack foods, including *K-time*™ bars in Australia, *Snack 'Ums*™ and *Pop-Tarts*® *Snak Stix*™ in the U.S., and specially formulated flavors of *Rice Krispies Treats*® in Southeast Asia, are establishing Kellogg Company as one of the fast-growing worldwide participants in the snacking category.
- As the traditional three meals a day gives way to daylong snacking, consumers recognize just how important it is that snacks be wholesome. Kellogg's® products respond to that need. That's why, for example, snackers are choosing great-tasting *Rice Krispies Treats*®, with just four grams of fat, over candy bars, which often contain 15 or more grams of fat.
- With the 1999 acquisition of Worthington Foods, Kellogg now provides a wide range of nutritious *Morningstar Farms*® products for meal and snacking occasions throughout the day. This segment also offers substantial opportunities for new product development.



renewing Kellogg's®

In today's global economy, having a first-class worldwide system to access raw materials, manufacture products of the highest quality, and distribute them to billions of consumers innovatively and efficiently is a business growth essential. Kellogg Company's global "supply chain" and sales organizations are making substantial year-to-year progress toward that goal.

- Increasingly, grains and other raw materials and services are obtained on a worldwide contract basis, providing both cost and quality advantages.
- Our network of 35 manufacturing plants in 20 countries (indicated on map at right) is engaged in a major initiative to make the greatest possible operational use of all capital assets. Through these programs, productivity across our global cereal business has improved by 230 percent since 1990.
- New distribution systems that reach on-the-go consumers are greatly enhancing our growth prospects. In Asia, Kellogg vans and motor scooters rush snack-sized Kellogg's™ Rice Krispies Treats™ to street-corner vendors and small shops. In Mexico, Kellogg's® convenience foods reach thousands of new outlets each year through a dedicated fleet of light trucks. In the United Kingdom, Kellogg's® Nutri-Grain® bars are a favorite of busy commuters at rail terminals and other transportation centers. In the United States, our products' presence in vending machines, at check-out counters, and in other single-serve outlets continues to grow at a double-digit annual rate.
- A developing global foodservice network promises strong growth for Kellogg over the long term at schools, hospitals, and other away-from-home dining and snacking locations around the world.



Through A World-Class Infrastructure



renewing Kellogg's®

Through Superior Performance

As competitive conditions become more and more intense in the new century, it is imperative that Kellogg Company build and maintain the finest, highest performing organization in the food industry. Steps we are taking to achieve this essential goal include:

- A new internal training and development program, to enable Kellogg people to fully develop their talents and make ever-increasing contributions to the success of our Company.
- A totally revamped recruiting strategy, including stronger relationships with a selected group of schools that are sources of the best talent.
- A new performance appraisal system that focuses much more heavily on rewarding exceptional performance.

Over the years, Kellogg and many other companies have let the line blur too much between average performance and the superior performance that drives growth.

- An intense emphasis on strength through diversity, including mandatory diversity training for our officers and internal programs focusing on the critically important value that people with diverse backgrounds and perspectives bring to Kellogg Company.

Superior performance by Kellogg people will be a clear competitive strength in the years to come.



Below:
Representatives of
Kellogg Company's global
supply chain team.



Management's Discussion and Analysis

Kellogg Company and Subsidiaries

Results of operations

Overview

Kellogg Company is the world's leading producer of ready-to-eat cereal and a leading producer of convenience foods, including toaster pastries, cereal bars, frozen waffles, and meat alternatives. Principal markets for these products include the United States and United Kingdom. Operations are managed via four major geographic areas – North America, Europe, Asia-Pacific, and Latin America – which are the basis of the Company's reportable operating segment information.

During 1999, the Company increased sales and achieved double-digit growth in net earnings and earnings per share, excluding charges (discussed below). Volume gains in the Company's Latin America and Asia-Pacific cereal markets, continued expansion of the Company's global convenience foods business, and cost savings from ongoing streamlining and efficiency initiatives contributed significantly to these results.

During 1998, the Company realized declines in earnings per share, both with and without charges. The Company experienced significant competitive pressure combined with category softness in its major ready-to-eat cereal markets, to which it responded by accelerating investment in long-term growth strategies, including product development, technology, and efficiency initiatives.

For 1999, Kellogg Company reported net earnings and earnings per share of \$338.3 million and \$.83, respectively, compared to 1998 net earnings of \$502.6 million and net earnings per share of \$1.23. Net earnings and earnings per share for 1997 were \$546.0 million and \$1.32, respectively. (All earnings per share presented represent both basic and diluted earnings per share.)

During the current and prior years, the Company reported charges for restructuring, dispositions, and asset impairment losses that have been excluded from all applicable amounts presented below for purposes of comparison between years. Additionally, results for 1997 are presented before the cumulative effect of a change in the method of accounting for business process reengineering costs. Refer to "Charges & accounting change – summary" on page 15, and the related sections that follow, for further information.

1999 compared to 1998

Excluding charges, 1999 net earnings of \$606.2 million were up 10.4% from the 1998 level of \$548.9 million. Net earnings per share increased 11.1% from \$1.35 in 1998 to \$1.50 in 1999. The \$.15 increase in earnings per share consisted of \$.14 from business growth, \$.01 from favorable foreign exchange movements, and \$.01 from prior-year share repurchase, partially offset by \$.01 due to a higher effective tax rate.

The Company realized the following volume results during 1999:

	Change
North America	+2.4%
Europe	+1.3%
Asia-Pacific	+13.1%
Latin America	+8.8%
Consolidated	+3.4%

	Change
Global cereal	+1.6%
Global convenience foods	+8.8%
Consolidated	+3.4%

In North America, cereal volume was relatively flat, due primarily to a significant reduction in U.S. volume during the fourth quarter. Management believes this reduction resulted from a non-competitive level of marketing spending by the Company during the period. Excluding the impact of acquisitions and dispositions (refer to page 17), the North American convenience foods business achieved low double-digit volume growth. The Company's Asia-Pacific and Latin America segments achieved records for annual cereal volume delivery. Cereal volume increased slightly in the Company's European segment amid extremely competitive conditions and loss of a major customer in Germany. Convenience food volumes significantly exceeded the prior year in all operating segments, due primarily to continued new product rollouts and market expansion.

The Company continued to lead the global ready-to-eat cereal category with an estimated 37% annualized share of worldwide volume. Category share for the Company's operating segments was approximately 32% in North America, 40% in Europe, 43% in Asia-Pacific, and 60% in Latin America.

Consolidated net sales increased 3.3%, due primarily to volume gains and favorable product mix movements, partially offset by unfavorable foreign currency impact. On an operating segment basis, net sales versus the prior year were:

	North America	Europe	Asia-Pacific	Latin America	Consolidated
Business	+4.3%	-1.0%	+11.1%	+20.1%	+4.6%
Foreign currency impact	+1.1%	-3.9%	+6.1%	-9.1%	-1.3%
Total change	+4.4%	-4.9%	+17.2%	+11.0%	+3.3%

Net sales by major product group were (in millions):

	1999	1998	Change
Global cereal	\$ 5,304.7	\$ 5,265.4	+7%
Global convenience foods	1,679.5	1,496.7	+12.2%
Consolidated	\$6,984.2	\$6,762.1	+3.3%

Margin performance for 1999 and 1998 was:

	1999	1998	Change
Gross margin	52.4%	51.5%	+9%
SGA% (a)	37.0%	37.2%	+2%
Operating margin	15.4%	14.3%	+1.1%

(a) Selling, general, and administrative expense as a percentage of net sales.

The 1999 gross margin improved versus the prior year, due primarily to global manufacturing efficiencies. The SGA% was relatively flat, as increased spending on promotional activities offset benefits from overhead streamlining initiatives around the world. This level of spending is consistent with management's strategy to drive growth through increased marketing investment in the Company's established cereal markets, as well as supporting the introduction of new convenience food products around the world.

Operating profit on an operating segment basis was:

(millions)	North America	Europe	Asia-Pacific	Latin America	Corporate and other	Consolidated
1999 operating profit	\$ 668.8	\$ 201.7	\$ 48.6	\$ 139.6	(\$ 229.9)	\$ 828.8
Restructuring charges	197.9	22.4	4.6	1.7	18.0	244.6
1999 operating profit excluding restructuring charges	\$866.7	\$224.1	\$53.2	\$141.3	(\$211.9)	\$1,073.4
1998 operating profit	\$ 790.8	\$ 208.1	\$ 44.9	\$ 107.2	(\$ 255.9)	\$ 895.1
Restructuring charges	40.8	3.3	3.4	—	23.0	70.5
1998 operating profit excluding restructuring charges	\$831.6	\$211.4	\$48.3	\$107.2	(\$232.9)	\$ 965.6
% change — 1999 vs. 1998						
Business	+4.2%	+10.3%	+3.8%	+39.1%	+8.4%	+12.4%
Foreign currency impact	—	-4.3%	+6.4%	-7.3%	+6%	-1.2%
Total change	+4.2%	+6.0%	+10.2%	+31.8%	+9.0%	+11.2%

Gross interest expense, prior to amounts capitalized, was \$127.2 million, comparable to the prior-year amount of \$127.3 million.

Other income (expense), net includes non-operating items such as interest income, foreign exchange gains and losses, and charitable donations. Other income (expense), net for 1998 includes a credit of approximately \$6 million related to settlement of certain litigation. During 1996, the Company included in operating profit a provision of \$15 million for the potential settlement of this litigation, which brought the total settlement reserve to \$18 million. This litigation was settled during the second quarter of 1998 for a cost of approximately \$12 million, and the remaining reserve of approximately \$6 million was reversed.

Excluding the impact of charges, the effective income tax rate for 1999 was 36.2%, compared to the prior-year rate of 35.7%. A statutory rate reduction in Australia favorably impacted the 1999 tax rate by .6%. A statutory rate reduction in the United Kingdom reduced the 1998 effective rate by .3%. The effective income tax rate based on reported earnings was 37.0% for 1999 and 35.8% for 1998. The variance in the 1999 reported rate (as compared to the rate excluding the impact of charges) relates primarily to the disposition of

nondeductible goodwill from the Lender's Bagels business and certain restructuring charges for which no tax benefit was provided, based on management's assessment of the likelihood of recovering such benefit in future years.

1998 compared to 1997

Excluding charges, 1998 net earnings were \$548.9 million, compared to 1997 net earnings (before cumulative effect of accounting change) of \$704.5 million. The Company reported 1998 earnings per share of \$1.35, a 20.6% decrease from the prior-year result of \$1.70. The year-over-year decrease in earnings per share of \$.35 resulted from \$.33 of business decline, \$.01 of unfavorable tax rate movements, and \$.03 of unfavorable foreign currency movements, partially offset by a \$.02 benefit from share repurchase. The business decline was attributable principally to cereal category softness and competitive pressures in North America and Europe, and continued global investments in brand-building marketing activities and operational efficiency programs.

The Company realized the following volume results during 1998:

	Change
North America	-4.3%
Europe	-1.2%
Asia-Pacific	+6.9%
Latin America	+16.2%
Global total	-1.3%

	Change
Global cereal	-2.0%
Global convenience foods	+1.1%
Global total	-1.3%

Within North America and Europe, volume declines were due principally to softness in the ready-to-eat cereal business. Asia-Pacific experienced record volume due to a combination of cereal growth and new convenience food product introductions. Latin America continued to post double-digit increases in both ready-to-eat cereal and convenience foods, with record volume results throughout 1998. The global convenience foods volume increase was driven by double-digit growth in the Company's international markets offset by softness within North America, due primarily to declines in the Lender's Bagels business.

Consolidated net sales decreased 1.0% for 1998. Adjusted for unfavorable foreign currency movements, sales were up .5% from the prior year, with the unfavorable impact of volume declines more than offset by favorable pricing and product mix movements. On an operating segment basis, net sales versus the prior year were:

	North America	Europe	Asia-Pacific	Latin America	Consolidated
Business	-1.5%	-2%	+6.1%	+15.7%	+5%
Foreign currency impact	-5%	+1%	-14.6%	-3.6%	-1.5%
Total change	-2.0%	-1%	-8.5%	+12.1%	-1.0%

Net sales by major product group were (in millions):

	1998	1997	Change
Global cereal	\$ 5,265.4	\$ 5,435.8	-3.1%
Global convenience foods	1,496.7	1,394.3	+7.3%
Consolidated	\$6,762.1	\$6,830.1	-1.0%

Margin performance for 1998 and 1997 was:

	1998	1997	Change
Gross margin	51.5%	52.1%	-.6%
SGA%(a)	37.2%	34.6%	-2.6%
Operating margin	14.3%	17.5%	-3.2%

(a) Selling, general, and administrative expense as a percentage of net sales.

The gross margin decline was due to a combination of the fixed cost absorption impact of lower volumes combined with incremental costs related to launching new products in Europe and North America. The increase in SGA% reflects increased global research and development costs to support the Company's ongoing innovation strategy combined with significant marketing investment and increased spending on operational efficiency programs.

Operating profit on an operating segment basis was:

(millions)	North America	Europe	Asia-Pacific	Latin America	Corporate and other	Consolidated
1998 operating profit excluding charges (a)	\$831.6	\$211.4	\$48.3	\$107.2	(\$232.9)	\$ 965.6
1997 operating profit as reported	\$ 847.0	\$ 189.9	\$ 22.5	\$ 111.6	(\$ 161.9)	\$ 1,009.1
Charges (a)	37.8	115.9	28.6	.2	1.6	184.1
1997 operating profit excluding charges	\$884.8	\$305.8	\$51.1	\$111.8	(\$160.3)	\$1,193.2
% change – 1998 vs. 1997						
Business	-5.7%	-31.3%	+10.2%	-1.5%	-44.2%	-17.8%
Foreign currency impact	-.3%	+.4%	-15.6%	-2.6%	-1.0%	-1.3%
Total change	-6.0%	-30.9%	-5.4%	-4.1%	-45.2%	-19.1%

(a) 1998-restructuring charges; 1997-restructuring charges and asset impairment losses. Refer to sections below on charges for further information.

Gross interest expense, prior to amounts capitalized, increased 8.0% to \$127.3 million versus the prior-year amount of \$117.9 million. The higher interest expense resulted from overall increased debt levels, partially offset by a lower effective interest rate.

Excluding the impact of charges, the effective income tax rate was 35.7%, an increase of .4 percentage points versus the prior-year rate of 35.3%. The higher effective tax rate was due primarily to lower earnings and country mix. For both 1998 and 1997, the effective tax rate benefited from statutory rate reductions in the United Kingdom, as well as favorable adjustments in other jurisdictions. The effective income tax rate based on reported earnings (before cumulative effect of accounting change) was 35.8% in 1998 and 37.6% in 1997. For 1997, the higher reported rate (as compared to the rate excluding charges) relates primarily to certain restructuring charges for which no tax benefit was provided, based on management's assessment of the likelihood of recovering such benefit in future years.

Charges & accounting change – summary

The table below summarizes the amounts that have been excluded from results of operations above for purposes of comparison between years. These items are discussed in detail in the following sections.

(millions, except per share data)	Impact on			
	Operating profit	Earnings before income taxes & cumulative effect of accounting change	Net earnings	Net earnings per share
1999				
Restructuring charges	\$ 244.6	\$ 244.6	\$ 156.4	\$.40
Disposition-related charges	—	168.5	111.5	.27
Total charges	\$244.6	\$413.1	\$267.9	\$.67
1998				
Restructuring charges	\$ 70.5	\$ 70.5	\$ 46.3	\$.12
1997				
Restructuring charges	\$ 161.1	\$ 161.1	\$ 125.5	\$.30
Asset impairment losses	23.0	23.0	15.0	.04
Total charges	\$184.1	\$184.1	\$140.5	\$.34
Cumulative effect of accounting change	—	—	\$18.0	\$.04

Restructuring charges & asset impairment losses

Restructuring charges

During the current and prior years, management has commenced major productivity and operational streamlining initiatives in an effort to optimize the Company's cost structure. The incremental costs of these programs have been reported during these years as restructuring charges.

The 1999 restructuring charges consist of \$193.2 million for closing the South Operations portion of the Company's Battle Creek, Michigan, cereal plant, \$32.7 million for workforce reduction initiatives around the world, and \$18.7 million, primarily for manufacturing equipment write-offs related to previously closed or impaired facilities in various locations.

Approximately one-half of the charges for the South Operations closing are comprised of asset write-offs, with the remainder consisting primarily of cash costs for employee retirement and separation benefits, equipment removal, and building demolition. As part of the Company's strategy of continuing cost reduction and efficiency improvement, these operations were closed in October 1999. Some production capacity is being relocated to the Company's other North American cereal plants. Approximately 525 hourly and salaried positions at the Battle Creek plant will be eliminated by the end of the first quarter of 2000 through a combination of voluntary and involuntary separation programs. These actions are expected to result in estimated annual pretax savings of \$35 to \$45 million, a portion of which will be realized in 2000.

The charges for workforce reduction initiatives are comprised principally of employee retirement and separation benefit costs in all four of the Company's operating segments and in corporate operations. These initiatives eliminated approximately 325 employee positions in Europe, Asia-Pacific, and Latin America during 1999 and are expected to generate approximately \$25 million in pretax savings in 2000.

The 1998 restructuring charges relate primarily to an overhead activity analysis that resulted in the elimination of approximately 550 employees and 240 contractors from the Company's headquarters and North American operations through a combination of involuntary early retirement and severance programs. The charges consist mainly of employee retirement and separation benefits. This program generated approximately \$100 million of pretax savings during 1999.

The 1997 restructuring charges relate principally to management's plan to optimize the Company's pan-European operations, as well as ongoing productivity programs in the United States and Australia. A major component of the pan-European initiatives was the late-1997 closing of plants and separation of employees in Riga, Latvia; Svendborg, Denmark; and Verola, Italy. Approximately 50% of the total 1997 restructuring charges consist of manufacturing asset write-downs, with the balance comprised principally of current and anticipated cash outlays for employee separation benefits and equipment removal. The 1997 charges also include approximately \$41 million of program-related non-exit costs, such as production redeployment and associated consulting, incurred during 1997. The 1997 programs eliminated approximately 600 positions by the end of 1998. Total pretax savings from these programs, 60% of which was realized by the end of 1999, are expected to be approximately \$50 million.

Refer to Note 3 within Notes to Consolidated Financial Statements for information on the components of the restructuring charges by initiative, as well as reserve balances remaining at December 31, 1999, 1998, and 1997.

Incremental pretax savings achieved or expected from streamlining initiatives by year, and the relative impact on captions within the Consolidated Statement of Earnings, are:

(millions)	Incremental pretax savings	Relative impact on	
		Cost of goods sold	SGA (a)
1997	\$ 60	75%	25%
1998	10	75%	25%
1999	125	10%	90%
2000 expected	50	80%	20%

(a) Selling, general, and administrative expense.

Total cash outlays incurred or expected for streamlining initiatives by year are:

(millions)	
1997	\$85
1998	47
1999	69
2000 expected	60

Asset impairment losses

During 1997, the Company included in operating profit \$23.0 million of asset impairment losses, resulting from evaluation of the Company's ability to recover components of its investments, based on management's ongoing strategic assessment of local conditions, in the emerging markets of Asia-Pacific. These investments consist of cereal manufacturing plant, property, and equipment located in India and China. In both of these markets, demand for the Company's locally produced products has fallen short of expectations during the initial years of operation. As of year-end 1997, the future cash flows expected to be generated from these operations were not projected to support the current carrying value of the manufacturing assets during their remaining useful lives. Therefore, pursuant to Statement of Financial Accounting Standards (SFAS) No. 121 "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of," management reduced the carrying value of these assets to fair market value. Fair market value was based on independent real estate appraisal in the case of plant and property, and internal engineering evaluations in the case of equipment. These assets are currently being held and used with no plans for future disposal. Management is implementing new strategies in these markets that leverage the Company's ability to appeal to local tastes.

2000 events

The Company's streamlining initiatives will continue in 2000. The Company expects to implement streamlining initiatives in its European supply chain as part of an ongoing efficiency program. As a result of this action, the Company expects to record pretax restructuring charges of approximately \$25 million in the second quarter of 2000.

The foregoing discussion of streamlining initiatives contains forward-looking statements regarding future charges, headcount reductions, cash requirements, and realizable savings. Actual amounts may vary depending on the final determination of important factors, such as identification of specific employees to be separated from pre-determined pools, final negotiation of third-party contract buy-outs, actual expenditures for facility closures, implementation of cost-reduction programs currently in the planning stages, and other items.

Acquisitions & dispositions

Acquisitions

On November 29, 1999, the Company purchased the outstanding common stock of Worthington Foods, Inc. for approximately \$300 million in cash, including related acquisition costs. Additionally, during December 1999, the Company paid off approximately \$50 million of Worthington debt existing at the acquisition date. Worthington Foods, Inc. is the leading manufacturer and marketer of soy protein-based meat alternatives and other healthful foods. The acquisition was accounted for as a purchase and was financed through commercial paper borrowings. Results of Worthington Foods, Inc. operations have been included in the Company's consolidated results from the date of acquisition. The impact of this acquisition on the Company's fourth quarter 1999 results was insignificant. The purchase price allocation includes approximately \$12 million of exit liabilities, comprised principally of employee involuntary separation and relocation benefits. Refer to Note 2 within Notes to Consolidated Financial Statements for further information.

On January 20, 2000, the Company purchased certain assets and liabilities of the Mondo Baking Company Division of Southeastern Mills, Inc. for approximately \$92 million in cash, including related acquisition costs. Mondo Baking Company, located in Rome, Georgia, has manufactured convenience foods for Kellogg since 1993. The acquisition was accounted for as a purchase and was financed through commercial paper borrowings. Assets acquired consist primarily of a manufacturing facility and assembled workforce.

Dispositions

During November 1999, the Company sold certain assets and liabilities of the Lender's Bagels business to Aurora Foods Inc. for \$275 million in cash. As a result of this transaction, the Company recorded a pretax charge of \$178.9 million (\$119.3 million after tax or \$.29 per share). This charge includes approximately \$57 million for the future disposal of other assets associated with the Lender's business, which were not purchased by Aurora.

During July 1999, the Company sold its 51% interest in a United Kingdom corn milling operation to Cargill Inc., which owned the remaining 49%. As a result of this sale, the Company recorded a pretax gain of \$10.4 million (\$7.8 million after tax or \$.02 per share).

In total, the Company recorded net disposition-related charges of \$168.5 million (\$111.5 million after tax or \$.27 per share) during the third quarter of 1999. The impact of these dispositions on operating results during the fourth quarter of 1999 was insignificant.

Accounting change

On November 20, 1997, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) reached a consensus in EITF 97-13 that the costs of business process reengineering activities are to be expensed as incurred. Accordingly, for the fourth quarter of 1997, the Company reported a charge of \$18.0 million (net of tax benefit of \$7.7 million) or \$.04 per share for write-off of business process reengineering costs. Such costs were expensed as incurred during 1999, 1998, and the fourth quarter of 1997, and were insignificant.

Liquidity and capital resources

The Company's financial condition remained strong during 1999. A strong cash flow, combined with a program of issuing commercial paper and maintaining worldwide credit facilities, provides adequate liquidity to meet the Company's operational needs. The Company continues to maintain a Prime-1 rating on its commercial paper.

For 1999, net cash provided by operating activities was \$795.2 million, up 10.5% from \$719.7 million in 1998. The increase was due primarily to higher earnings before restructuring and disposition-related charges, partially offset by unfavorable working capital movements. The unfavorable working capital movements were attributable principally to increased inventory levels and reduced accounts payable balances. The increased inventory levels were related primarily to temporary inventory build due to the South Operations plant closing, as discussed in the "Restructuring charges" section on page 15. Reduced capital spending and cost savings from operational efficiency initiatives contributed to the lower accounts payable balances. At December 31, 1999, the ratio of current assets to current liabilities was 1.0, up from .9 at December 31, 1998.

Net cash used in investing activities was \$244.2 million, down from \$398.0 million in 1998. The decrease was due primarily to a reduction in capital spending, with the effect of acquisitions and dispositions essentially offsetting during 1999.

Net cash used in financing activities was \$527.6 million, related primarily to dividend payments of \$388.7 million and a net decrease in total debt of \$151.8 million. The Company's total 1999 per share dividend payment of \$.96, up from \$.92 in 1998, represents the 43rd consecutive year the Company has increased its dividend.

During 1999, management was authorized by the Company's Board of Directors to repurchase up to \$149.4 million in shares of the Company's common stock. There were no repurchases during 1999. For 2000, the Company's Board of Directors has authorized management to repurchase up to \$150.0 million in common shares.

Notes payable consist primarily of commercial paper borrowings in the United States and borrowings under a \$200 million revolving credit agreement in Europe with several international banks. At December 31, 1999, outstanding borrowings under the revolving credit agreement were \$16.2 million with an effective interest rate of 5.6%. U.S. borrowings at December 31, 1999, were \$448.3 million with an effective interest rate of 5.9%.

Long-term debt consists primarily of fixed rate issuances of U.S. and Euro Dollar Notes, including \$900 million due in 2001, \$500 million due in 2004, and \$200 million due in 2005. The amount due in 2001 includes \$400 million in Notes which provide an option to holders to extend the obligation for an additional four years at a predetermined interest rate of 5.63% plus the Company's then-current credit spread.

Associated with several of these long-term debt issuances, the Company has entered into fixed-to-floating interest rate swaps, generally expiring in conjunction with the debt issuances and indexed to either three-month London Interbank Offered Rate (LIBOR) or the Federal Reserve AA Composite Rate on 30-day commercial paper. Refer to Note 7 of Notes to Consolidated Financial Statements for further information on debt and related swaps.

The percentage of total debt to market capitalization at December 31, 1999, was 17%, up from 16% at December 31, 1998, due primarily to a lower stock price since the prior year-end.

Year 2000

The Company established a global program in 1997 to address the millennium date change issue (the inability of certain computer software, hardware, and other equipment with embedded computer chips to properly process two-digit year-date codes after 1999). As a result of executing this program in a timely manner, the Company has not experienced any significant date-related failures. While failures are still possible, management believes that the financial impact of any future failures is not likely to be significant.

The Company spent approximately \$65 million during 1998 and 1999 to become Year 2000 compliant, and expects minimal additional spending during 2000. This amount excludes the cost of other planned system initiatives that have contributed to the overall Year 2000 readiness effort, but were implemented primarily for other business reasons.

Euro conversion

On January 1, 1999, eleven European countries (Germany, France, Spain, Italy, Ireland, Portugal, Finland, Luxembourg, Belgium, Austria, and the Netherlands) implemented a single currency zone, the Economic and Monetary Union (EMU). The new currency, the Euro, has become the official currency of the participating countries. Those countries' financial markets and banking systems are quoting financial and treasury data in Euros from January 1, 1999.

The Euro is existing alongside the old national currencies during a transition period from January 1, 1999, to January 1, 2002. During this period, entities within participating countries must complete changes that enable them to transact in the Euro. National currencies will be withdrawn no later than July 1, 2002. This transition to the Euro currency involves changing budgetary, accounting, pricing, costing, and fiscal systems in companies and public administrations, as well as the simultaneous handling of parallel currencies and conversion of data. During 1999, the Euro currency weakened versus the U.S. Dollar and British Pound. The Euro needs to be observed over a longer period before conclusions can be drawn on the currency's long-term strength.

In early 1998, management formed a task force to monitor EMU developments, evaluate the impact of the Euro conversion on the Company's operations, and develop and execute action plans, as necessary. Required business strategy, system, and process changes within the Company's European region are being completed in accordance with the Company's timetable for transacting with its suppliers and customers in the Euro, beginning in 2001.

The Company's Euro program consists of two phases. Phase I aims to provide the business with the capability to recognize the Euro as a foreign currency for customer order-taking, invoice processing, and supplier payment purposes. The Company expects to complete the necessary changes to order management and related financial systems prior to 2001. Management believes the project timetable is on target to meet this date.

In Phase II, the more significant portion of the program, all business systems (for example, raw materials management, manufacturing, warehousing, and human resource systems) will be reviewed and modified, as necessary, to handle the Euro as a functional currency. Legally, this capability must exist in Company business units operating in EMU member countries from January 1, 2002. Operational systems are currently being analyzed and modified in order to comply with the legal timetable.

Although management currently believes the Company will be able to accommodate any required changes in its operations, there can be no assurance that the Company, its customers, suppliers, financial service providers, or government agencies will meet all of the Euro currency requirements on a timely basis. This is, in part, because new requirements may emerge from individual national governments at later stages. Such failure to complete the necessary work could result in material financial risk.

New accounting pronouncements

Effective January 1, 1999, the Company adopted two Statements of Position (SOP) issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. SOP 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" provides guidance on the classification of software project costs between expense and capital. SOP 98-5 "Reporting on Costs of Start-up Activities" prescribes that the costs of opening a new facility, commencing business in a new market, or similar start-up activities must be expensed as incurred. SOP 98-1 has been applied on a prospective basis from January 1, 1999. The initial application of SOP 98-5 was to be reported as a cumulative effect of a change in accounting principle, if material. The adoption of these SOPs did not have a significant impact on the Company's financial results during 1999.

In June 1998, the FASB issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." This Statement established accounting and reporting standards for derivative instruments, requiring recognition of the fair value of all derivatives as assets or liabilities on the balance sheet. SFAS No. 133 was to be effective for fiscal years beginning after June 15, 1999. In July 1999, the FASB issued SFAS No. 137 "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 137 delays the effective date of SFAS No. 133 by one year. The Company will adopt SFAS No. 133 on January 1, 2001. Management does not expect the adoption to have a significant impact on the Company's financial results.

2000 outlook

Management is not aware of any adverse trends that would materially affect the Company's strong financial position. Should suitable investment opportunities or working capital needs arise that would require additional financing, management believes that the Company's strong credit rating, balance sheet, and earnings history provide a base for obtaining additional financial resources at competitive rates and terms.

Cereal market conditions continue to be very challenging in both the United States and United Kingdom; however, management believes the Company is making progress in strengthening the fundamentals of its cereal business. The Company's goal is to achieve solid, reliable growth in its established cereal markets, combined with high growth in its global convenience foods business and in its developing and emerging cereal businesses. Management believes this strategy should deliver annual net sales growth of 4-6%. Management expects that this rate of growth, combined with continued improvements in operational efficiency, should produce operating profit growth of 8-10% and low double-digit growth in earnings per share for 2000, excluding charges.

Additional expectations for 2000 include the following approximate results: gross profit margin of 53%, SGA% of 37%, effective income tax rate of 36%, and capital spending of \$270 million.

As discussed on page 17, the Company acquired Worthington Foods and divested the Lender's Bagels business in late 1999. Management expects the net impact of these events on 2000 earnings per share to be approximately neutral. The net impact on sales and operating profit growth is expected to be insignificant.

Forward-looking statements

From time to time, in written reports and oral statements, the Company makes "forward-looking statements" discussing, among other things, projections concerning volume, sales, operating profit growth, gross profit margin, SGA%, effective income tax rate, capital spending; the impact of acquisitions and dispositions; Year 2000 date-related issues; and the Euro conversion project. Forward-looking statements include predictions of future results and may contain the words "expects", "believes", "will", "will deliver", "anticipates", "projects", or words or phrases of similar meaning. For example, forward-looking statements are found in the 1999 Annual Report to Share Owners in the letter from Mr. Gutierrez and Mr. Langbo and in several sections of the Management's Discussion and Analysis. Actual results may differ materially due to the impact of competitive conditions, marketing spending, and/or incremental pricing actions on actual volumes and product mix; the success of new product introductions; the levels of spending on system initiatives, properties, business opportunities, continued streamlining initiatives, integration of acquired businesses, and other general and administrative costs; raw material price and labor cost fluctuations; foreign currency exchange rate fluctuations; changes in statutory tax law; interest rates available on short-term financing; the ability of the Company's or third parties' computer software, hardware, and other equipment with embedded computer chips to properly process two-digit year-date codes; the ability of the Company or third parties to meet all of the Euro currency requirements on a timely basis; and other items. Forward-looking statements speak only as of the date they were made, and the Company undertakes no obligation to publicly update them.

Selected Financial Data

(millions, except per share data and number of employees)

	Net sales	% Growth	(a) Operating profit	% Growth	(a)(b) Earnings before accounting change	% Growth	Average shares outstanding (c)
1999	\$6,984.2	3%	\$ 828.8	(7)%	\$338.3	(33)%	405.2
1998	6,762.1	(1)	895.1	(11)	502.6	(11)	407.8
1997	6,830.1	2	1,009.1	5	564.0	6	414.1
1996	6,676.6	(5)	958.9	14	531.0	8	424.9
1995	7,003.7	7	837.5	(28)	490.3	(30)	438.3
1994	6,562.0	4	1,162.6	16	705.4	4	448.6
1993	6,295.4	2	1,004.6	(5)	680.7	—	463.0
1992	6,190.6	7	1,062.8	3	682.8	13	477.7
1991	5,786.6	12	1,027.9	16	606.0	21	482.4
1990	5,181.4	11	886.0	21	502.8	19	483.2
1989	4,651.7	7	732.5	(8)	422.1	(12)	488.4

	Total assets	Return on average assets	Shareholders' equity	Return on average equity	Property, net	Capital expenditures	Depreciation and amortization
1999	\$4,808.7	7%	\$ 813.2	40%	\$2,640.9	\$266.2	\$288.0
1998	5,051.5	10	889.8	53	2,888.8	373.9	278.1
1997	4,877.6	11	997.5	49	2,773.3	312.4	287.3
1996	5,050.0	11	1,282.4	37	2,932.9	307.3	251.5
1995	4,414.6	11	1,590.9	29	2,784.8	315.7	258.8
1994	4,467.3	16	1,807.5	40	2,892.8	354.3	256.1
1993	4,237.1	16	1,713.4	37	2,768.4	449.7	265.2
1992	4,015.0	11	1,945.2	21	2,662.7	473.6	231.5
1991	3,925.8	16	2,159.8	30	2,646.5	333.5	222.8
1990	3,749.4	14	1,901.8	28	2,595.4	320.5	200.2
1989	3,390.4	14	1,634.4	30	2,406.3	508.7	167.6

(a) Operating profit for 1999 includes restructuring charges of \$244.6 (\$156.4 after tax or \$.40 per share). Earnings before accounting change for 1999 include disposition-related charges of \$168.5 million (\$111.5 million after tax or \$.27 per share). Operating profit for 1998 includes restructuring charges of \$70.5 (\$46.3 after tax or \$.12 per share). Operating profit for 1997 includes restructuring charges of \$161.1 and asset impairment losses of \$23.0 (\$140.5 after tax or \$.34 per share). Operating profit for 1996 includes restructuring charges of \$136.1 (\$97.8 after tax or \$.23 per share). Earnings before accounting change for 1996 include a charge of \$35.0 (\$22.3 after tax or \$.05 per share) for a contribution to the Kellogg's Corporate Citizenship Fund. Operating profit for 1995 includes restructuring charges of \$348.0 and asset impairment losses of \$73.8 (\$271.3 after tax or \$.62 per share). Operating profit for 1993 includes asset impairment losses of \$64.3 (\$41.1 after tax or \$.09 per share). Refer to Management's Discussion and Analysis on pages 13-19 and Notes 2 and 3 within Notes to Consolidated Financial Statements for further explanation of charges for years 1997-1999.

(b) Earnings before accounting change for 1997 exclude the effect of a charge of \$18.0 after tax (\$.04 per share) to write off business process reengineering costs in accordance with guidance issued by the Emerging Issues Task Force of the FASB. Earnings before accounting change for 1992 and 1989 exclude the effect of adopting the following Statements of Financial Accounting Standards (SFAS): in 1992, a charge of \$251.6 (\$.53 per share) net of \$144.6 of income tax benefit for the transition effect of SFAS #106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and, in 1989, a gain of \$48.1 (\$.10 per share) for SFAS #96 "Accounting for Income Taxes."

Per Common Share Data (c)

(a)(b) Earnings before accounting change	Cash dividends	(d) Price/ earnings ratio	Stock price range	Net cash provided by operating activities	Net cash provided by/ (used in) financing activities	Common stock repurchases
\$.83	\$.96	37	\$30 - 42	\$ 795.2	(\$527.6)	\$ —
1.23	.92	28	30 - 50	719.7	(358.3)	239.7
1.36	.87	36	32 - 50	879.8	(607.3)	426.0
1.25	.81	26	31 - 40	711.5	94.0	535.7
1.12	.75	34	26 - 40	1,041.0	(759.2)	374.7
1.57	.70	18	24 - 30	966.8	(559.5)	327.3
1.47	.66	19	23 - 34	800.2	(464.2)	548.1
1.43	.60	23	27 - 37	741.9	(422.6)	224.1
1.26	.54	26	17 - 33	934.4	(537.7)	83.6
1.04	.48	18	14 - 19	819.2	(490.9)	86.9
.87	.43	20	14 - 20	533.5	(143.2)	78.6

Long-term debt	(e) Debt to market capitalization	Pretax interest coverage (times)	Current ratio	Advertising expense	R&D expense	Number of employees
\$1,612.8	17%	6	1.0	\$ 674.1	\$104.1	15,051
1,614.5	16	7	.9	695.3	121.9	14,498
1,415.4	10	9	.9	780.4	106.1	14,339
726.7	14	13	.7	778.9	84.3	14,511
717.8	5	12	1.1	891.5	72.2	14,487
719.2	8	23	1.2	856.9	71.7	15,657
521.6	7	27	1.0	772.4	59.2	16,151
314.9	3	33	1.2	782.3	56.7	16,551
15.2	3	17	.9	708.3	34.7	17,017
295.6	7	10	.9	648.5	38.3	17,239
371.4	10	10	.9	611.4	42.9	17,268

(c) All share data retroactively restated to reflect 2-for-1 stock splits in 1997 and 1991. All earnings per share data represent both basic and diluted earnings per share.

(d) The price/earnings ratio was calculated based on year-end stock price divided by earnings before the accounting changes referred to in note (b). These earnings include the charges referred to in note (a). Excluding the impact of these charges, the price/earnings ratio in 1999, 1998, 1997, 1996, 1995, and 1993 would have been 21, 25, 29, 21, 22, and 19, respectively.

(e) Debt to market capitalization was calculated based on year-end total debt balance divided by market capitalization. Market capitalization was calculated based on year-end stock price multiplied by the number of shares outstanding at year-end.

Consolidated Statement of Earnings

Year ended December 31,

(millions, except per share data)

	1999	1998	1997
Net sales	\$6,984.2	\$6,762.1	\$6,830.1
Cost of goods sold	3,325.1	3,282.6	3,270.1
Selling, general, and administrative expense	2,585.7	2,513.9	2,366.8
Restructuring charges	244.6	70.5	161.1
Asset impairment losses	—	—	23.0
Operating profit	828.8	895.1	1,009.1
Interest expense	118.8	119.5	108.3
Disposition-related charges	168.5	—	—
Other income (expense), net	(4.8)	6.9	3.7
Earnings before income taxes and cumulative effect of accounting change	536.7	782.5	904.5
Income taxes	198.4	279.9	340.5
Earnings before cumulative effect of accounting change	338.3	502.6	564.0
Cumulative effect of accounting change (net of tax)	—	—	(18.0)
Net earnings	\$ 338.3	\$ 502.6	\$ 546.0
Per share amounts (basic and diluted):			
Earnings before cumulative effect of accounting change	\$.83	\$ 1.23	\$ 1.36
Cumulative effect of accounting change	—	—	(.04)
Net earnings per share	\$.83	\$ 1.23	\$ 1.32

Refer to Notes to Consolidated Financial Statements.

Consolidated Statement of Shareholders' Equity

(millions)	Common stock		Capital in excess of par value	Retained earnings	Treasury stock		Accumulated other comprehensive income	Total shareholders' equity	Total comprehensive income
	shares	amount			shares	amount			
Balance, January 1, 1997	311.5	\$ 77.9	\$ 123.9	\$ 4,150.3	101.9	(\$2,903.4)	(\$ 166.3)	\$1,282.4	
Common stock repurchases (pre-split)					3.9	(290.9)		(290.9)	
Stock options exercised and other (pre-split)	.6	.1	31.9	—	—	(3.9)		28.1	
Retirement of treasury stock	(105.3)	(26.3)	(55.8)	(3,095.8)	(105.3)	3,177.9		—	
Two-for-one stock split	206.8	51.7	(51.7)		.5	—		—	
Common stock repurchases (post-split)					3.1	(135.1)		(135.1)	
Net earnings				546.0				546.0	\$ 546.0
Dividends				(360.1)				(360.1)	
Other comprehensive income							(115.6)	(115.6)	(115.6)
Stock options exercised and other (post-split)	1.2	.3	44.3		—	(1.9)		42.7	
Balance, December 31, 1997	414.8	103.7	92.6	1,240.4	4.1	(157.3)	(281.9)	997.5	430.4
Common stock repurchases					6.3	(239.7)		(239.7)	
Net earnings				502.6				502.6	502.6
Dividends				(375.3)				(375.3)	
Other comprehensive income							(10.5)	(10.5)	(10.5)
Stock options exercised and other	.5	.1	12.4		(.1)	2.7		15.2	
Balance, December 31, 1998	415.3	103.8	105.0	1,367.7	10.3	(394.3)	(292.4)	889.8	492.1
Common stock repurchases								—	
Net earnings				338.3				338.3	338.3
Dividends				(388.7)				(388.7)	
Other comprehensive income							(39.0)	(39.0)	(39.0)
Stock options exercised and other	.2	—	(.5)	(.1)	(.3)	13.4		12.8	
Balance, December 31, 1999	415.5	\$103.8	\$104.5	\$1,317.2	10.0	(\$ 380.9)	(\$331.4)	\$ 813.2	\$299.3

Refer to Notes to Consolidated Financial Statements.

Consolidated Balance Sheet

At December 31,

(millions, except share data)

	1999	1998
Current assets		
Cash and cash equivalents	\$ 150.6	\$ 136.4
Accounts receivable, net	678.5	693.0
Inventories	503.8	451.4
Other current assets	236.3	215.7
Total current assets	1,569.2	1,496.5
Property, net	2,640.9	2,888.8
Other assets	598.6	666.2
Total assets	\$4,808.7	\$5,051.5
Current liabilities		
Current maturities of long-term debt	\$ 2.9	\$ 1.1
Notes payable	518.6	620.4
Accounts payable	305.3	386.9
Other current liabilities	761.0	710.1
Total current liabilities	1,587.8	1,718.5
Long-term debt	1,612.8	1,614.5
Other liabilities	794.9	828.7
Shareholders' equity		
Common stock, \$.25 par value, 500,000,000 shares authorized Issued: 415,451,198 shares in 1999 and 415,343,626 in 1998	103.8	103.8
Capital in excess of par value	104.5	105.0
Retained earnings	1,317.2	1,367.7
Treasury stock at cost: 9,995,564 shares in 1999 and 10,346,524 shares in 1998	(380.9)	(394.3)
Accumulated other comprehensive income	(331.4)	(292.4)
Total shareholders' equity	813.2	889.8
Total liabilities and shareholders' equity	\$4,808.7	\$5,051.5

Refer to Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows

Year ended December 31,

(millions)	1999	1998	1997
Operating activities			
Net earnings	\$338.3	\$502.6	\$546.0
Items in net earnings not requiring (providing) cash:			
Depreciation and amortization	288.0	278.1	287.3
Deferred income taxes	(60.5)	46.2	38.5
Restructuring charges, net of cash paid	220.1	62.2	110.8
Disposition-related charges	168.5	—	—
Asset impairment losses	—	—	23.0
Other	65.7	21.7	9.5
Pension and other postretirement benefit contributions	(78.1)	(88.8)	(114.5)
Changes in operating assets and liabilities	(146.8)	(102.3)	(20.8)
Net cash provided by operating activities	795.2	719.7	879.8
Investing activities			
Additions to properties	(266.2)	(373.9)	(312.4)
Acquisitions of businesses	(298.2)	(27.8)	(25.4)
Dispositions of businesses	291.2	—	—
Property disposals	36.6	6.8	5.9
Other	(7.6)	(3.1)	2.6
Net cash used in investing activities	(244.2)	(398.0)	(329.3)
Financing activities			
Net reductions of notes payable,			
with maturities less than or equal to 90 days	(410.8)	(152.9)	(374.7)
Issuances of notes payable, with maturities greater than 90 days	292.1	5.5	4.8
Reductions of notes payable, with maturities greater than 90 days	(19.0)	(.8)	(14.1)
Issuances of long-term debt	—	600.0	1,000.0
Reductions of long-term debt	(14.1)	(210.3)	(507.9)
Net issuances of common stock	12.9	15.2	70.7
Common stock repurchases	—	(239.7)	(426.0)
Cash dividends	(388.7)	(375.3)	(360.1)
Net cash used in financing activities	(527.6)	(358.3)	(607.3)
Effect of exchange rate changes on cash	(9.2)	(.2)	(13.8)
Increase (decrease) in cash and cash equivalents	14.2	(36.8)	(70.6)
Cash and cash equivalents at beginning of year	136.4	173.2	243.8
Cash and cash equivalents at end of year	\$150.6	\$136.4	\$173.2

Refer to Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Kellogg Company and Subsidiaries

Note 1 Accounting policies

Consolidation

The consolidated financial statements include the accounts of Kellogg Company and its majority-owned subsidiaries. Intercompany balances and transactions are eliminated.

Certain amounts in the prior-year financial statements have been reclassified to conform to the current-year presentation.

Cash and cash equivalents

Highly liquid temporary investments with original maturities of less than three months are considered to be cash equivalents. The carrying amount approximates fair value.

Inventories

Inventories are valued at the lower of cost (principally average) or market.

Property

Fixed assets are recorded at cost and depreciated over estimated useful lives using straight-line methods for financial reporting and accelerated methods for tax reporting. Cost includes an amount of interest associated with significant capital projects.

Goodwill and other intangible assets

Intangible assets are amortized principally on a straight-line basis over the estimated periods benefited, generally 40 years for goodwill and periods ranging from 5 to 40 years for other intangible assets. The realizability of goodwill and other intangibles is evaluated periodically when events or circumstances indicate a possible inability to recover the carrying amount. Evaluation is based on undiscounted cash flow projections over the remaining life of the asset. An excess of carrying value over cash flows would result in recognition of an impairment loss. The amount of the loss would be based on the difference between carrying value and fair value of the asset, as measured by market comparables or discounted cash flows in the absence of market data.

Revenue recognition

The Company recognizes sales upon shipment of its products to customers net of applicable provisions for discounts, returns, and allowances.

Advertising

The costs of advertising are generally expensed as incurred.

Recently adopted pronouncements

Effective January 1, 1999, the Company adopted two Statements of Position (SOP) issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. SOP 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" provides guidance on the classification of software project costs between expense and capital. SOP 98-5 "Reporting on Costs of Start-up Activities" prescribes that the costs of opening a new facility, commencing business in a new market, or similar start-up activities must be expensed as incurred. SOP 98-1 has been applied on a prospective basis from January 1, 1999. The initial application of SOP 98-5 was to be reported as a cumulative effect of a change in accounting principle, if material. The adoption of these SOPs did not have a significant impact on the Company's financial results during 1999.

On November 20, 1997, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) reached a consensus in EITF 97-13 that the costs of business process reengineering activities are to be expensed as incurred. Accordingly, for the fourth quarter of 1997, the

Company reported a charge of \$18.0 million (net of tax benefit of \$7.7 million) or \$.04 per share for write-off of business process reengineering costs. Such costs were expensed as incurred during 1999, 1998, and the fourth quarter of 1997, and were insignificant.

Recently issued pronouncements

In June 1998, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities." This Statement established accounting and reporting standards for derivative instruments, requiring recognition of the fair value of all derivatives as assets or liabilities on the balance sheet. SFAS No. 133 was to be effective for fiscal years beginning after June 15, 1999. In July 1999, the FASB issued SFAS No. 137 "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 137 delays the effective date of SFAS No. 133 by one year. The Company will adopt SFAS No. 133 on January 1, 2001. Management does not expect the adoption to have a significant impact on the Company's financial results.

Common stock split

On August 1, 1997, the Company's Board of Directors approved a 2-for-1 stock split to shareholders of record at the close of business August 8, 1997, effective August 22, 1997, and also authorized retirement of 105.3 million common shares (pre-split) held in treasury. All per share and shares outstanding data in the Consolidated Statement of Earnings and Notes to Consolidated Financial Statements have been retroactively restated to reflect the stock split.

Stock compensation

The Company follows Accounting Principles Board Opinion (APB) #25, "Accounting for Stock Issued to Employees," in accounting for its employee stock options and other stock-based compensation. Under APB #25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized. As permitted, the Company has elected to adopt the disclosure provisions only of SFAS #123, "Accounting for Stock-Based Compensation." Refer to Note 8 for further information.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 Acquisitions & dispositions

Acquisitions

On November 29, 1999, the Company purchased the outstanding common stock of Worthington Foods, Inc. for approximately \$300 million in cash, including related acquisition costs. Additionally, during December 1999, the Company paid off approximately \$50 million of Worthington debt existing at the acquisition date. Worthington Foods, Inc. is the leading manufacturer and marketer of soy protein-based meat alternatives and other healthful foods. The acquisition was accounted for as a purchase and was financed through commercial paper borrowings. Results of Worthington Foods, Inc. operations have been included in the Company's consolidated results from the date of acquisition. The impact of this acquisition on the Company's fourth quarter 1999 results was insignificant.

The components of intangible assets included in the allocation of purchase price, along with the related straight-line amortization periods, were:

	Amount (millions)	Amortization period (yrs.)
Trademarks and tradenames	\$100.0	40
Goodwill	194.0	40
Total	\$294.0	

The purchase price allocation includes approximately \$12 million of exit liabilities, comprised principally of employee involuntary separation and relocation benefits.

The unaudited pro forma combined historical results, as if Worthington Foods, Inc. had been acquired at the beginning of fiscal 1999 and 1998, respectively, are estimated to be:

(millions, except per share data)	1999	1998
Net sales	\$7,130.1	\$6,901.6
Net earnings	\$ 323.6	\$ 493.3
Net earnings per share	\$.80	\$ 1.21

The pro forma results include amortization of the intangibles presented above and interest expense on debt assumed issued to finance the purchase. The pro forma results are not necessarily indicative of what actually would have occurred if the acquisition had been completed as of the beginning of each of the fiscal periods presented, nor are they necessarily indicative of future consolidated results.

On January 20, 2000, the Company purchased certain assets and liabilities of the Mondo Baking Company Division of Southeastern Mills, Inc. for approximately \$92 million in cash, including related acquisition costs. Mondo Baking Company, located in Rome, Georgia, has manufactured convenience foods for Kellogg since 1993. The acquisition was accounted for as a purchase and was financed through commercial paper borrowings. Assets acquired consist primarily of a manufacturing facility and assembled workforce.

Dispositions

During November 1999, the Company sold certain assets and liabilities of the Lender's Bagels business to Aurora Foods Inc. for \$275 million in cash. As a result of this transaction, the Company recorded a pretax charge of \$178.9 million (\$119.3 million after tax or \$.29 per share). This charge includes approximately \$57 million for disposal of other assets associated with the Lender's business, which were not purchased by Aurora.

During July 1999, the Company sold its 51% interest in a United Kingdom corn milling operation to Cargill Inc., which owned the remaining 49%. As a result of this sale, the Company recorded a pretax gain of \$10.4 million (\$7.8 million after tax or \$.02 per share).

In total, the Company recorded net disposition-related charges of \$168.5 million (\$111.5 million after tax or \$.27 per share) during the third quarter of 1999. The impact of these dispositions on operating results during the fourth quarter of 1999 was insignificant.

Note 3 Restructuring charges & asset impairment losses

Operating profit for 1999 includes restructuring charges of \$244.6 million (\$156.4 million after tax or \$.40 per share) for streamlining initiatives.

Operating profit for 1998 includes restructuring charges of \$70.5 million (\$46.3 million after tax or \$.12 per share) for streamlining initiatives.

Operating profit for 1997 includes restructuring charges for streamlining initiatives of \$161.1 million and asset impairment losses of \$23.0 million (\$140.5 million after tax or \$.34 per share).

Restructuring charges

During the current and prior years, management has commenced major productivity and operational streamlining initiatives in an effort to optimize the Company's cost structure. The incremental costs of these programs have been reported during these years as restructuring charges.

The 1999 restructuring charges consist of \$193.2 million for closing the South Operations portion of the Company's Battle Creek, Michigan, cereal plant, \$32.7 million for workforce reduction initiatives around the world, and \$18.7 million primarily for manufacturing equipment write-offs related to previously closed or impaired facilities in various locations.

As presented in the table on page 27, approximately one-half of the charges for the South Operations closing are comprised of asset write-offs, with the remainder consisting primarily of cash costs for employee retirement and separation benefits, equipment removal, and building demolition. As part of the Company's strategy of continuing cost reduction and efficiency improvement, these operations were closed in October 1999. Some production capacity is being relocated to the Company's other North American cereal plants. Approximately 525 hourly and salaried positions at the Battle Creek plant will be eliminated by the end of the first quarter of 2000 through a combination of voluntary and involuntary separation programs. These actions are expected to result in estimated annual pretax savings of \$35 to \$45 million, a portion of which will be realized in 2000.

The charges for workforce reduction initiatives are comprised principally of employee retirement and separation benefit costs in all four of the Company's operating segments and in corporate operations. These initiatives eliminated approximately 325 employee positions in Europe, Asia-Pacific, and Latin America during 1999 and are expected to generate approximately \$25 million in pretax savings in 2000.

The 1998 restructuring charges relate primarily to an overhead activity analysis that resulted in the elimination of approximately 550 employees and 240 contractors from the Company's headquarters and North American operations through a combination of involuntary early retirement and severance programs. The charges consist mainly of employee retirement and separation benefits. This program generated approximately \$100 million of pretax savings during 1999.

The 1997 restructuring charges relate principally to management's plan to optimize the Company's pan-European operations, as well as ongoing productivity programs in the United States and Australia. A major component of the pan-European initiatives was the late-1997 closing of plants and separation of employees in Riga, Latvia; Svendborg, Denmark; and Verola, Italy. Approximately 50% of the total 1997 restructuring charges consist of manufacturing asset write-downs, with the balance comprised principally of current and anticipated cash outlays for employee separation benefits and equipment removal. The 1997 charges also include approximately \$41 million of program-related non-exit costs, such as production redeployment and associated consulting, incurred during 1997. The 1997 programs eliminated approximately 600 positions by the end of 1998. Total pretax savings from these programs, 60% of which was realized by the end of 1999, are expected to be approximately \$50 million.

The components of the restructuring charges by initiative, as well as reserve balances remaining at December 31, 1999, 1998, and 1997, were:

U.S. operational streamlining	Employee retirement & severance benefits (a)	Asset write-offs	Asset removal	Other costs (d)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1996	\$ 3.3	\$ —	\$25.1	\$ —	\$ 28.4
1997 restructuring charges	—	22.2	6.8	6.2	35.2
Amounts utilized during 1997	(3.3)	(22.2)	(16.8)	(6.2)	(48.5)
Remaining reserve at December 31, 1997	—	—	15.1	—	15.1
1998 restructuring charges	—	—	—	—	—
Amounts utilized during 1998	—	—	(6.6)	—	(6.6)
Remaining reserve at December 31, 1998	—	—	8.5	—	8.5
1999 restructuring charges	55.5	108.4	28.2	1.1	193.2
Amounts utilized during 1999	(34.1)	(108.4)	(8.6)	(1.1)	(152.2)
Remaining reserve at December 31, 1999	\$21.4	\$ —	\$28.1	\$ —	\$ 49.5

Pan-European reorganization	Employee retirement & severance benefits	Asset write-offs	Asset removal	Other costs (d)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1996	\$11.4	\$ —	\$ 2.6	\$ —	\$ 14.0
1997 restructuring charges	19.6	54.7	11.3	33.5	119.1
Amounts utilized during 1997	(11.6)	(54.7)	(3.8)	(33.5)	(103.6)
Remaining reserve at December 31, 1997	19.4	—	10.1	—	29.5
1998 restructuring charges	—	—	—	—	—
Amounts utilized during 1998	(17.6)	—	(11.5)	—	(29.1)
Remaining reserve at December 31, 1998 (c)	1.8	—	(1.4)	—	.4
1999 restructuring charges	10.9	10.9	.6	—	22.4
Amounts utilized during 1999	(10.0)	(10.9)	(.4)	—	(21.3)
Remaining reserve at December 31, 1999 (c)	\$ 2.7	\$ —	(\$ 1.2)	\$ —	\$ 1.5

Australian plant productivity program	Employee retirement & severance benefits	Asset write-offs	Asset removal	Other costs (d)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1996	\$7.0	\$ —	\$2.7	\$ —	\$9.7
1997 restructuring charges	2.7	.6	.6	1.1	5.0
Amounts utilized during 1997	(5.7)	(.6)	(.8)	(1.1)	(8.2)
Remaining reserve at December 31, 1997	4.0	—	2.5	—	6.5
1998 restructuring charges	—	—	—	—	—
Amounts utilized during 1998	(1.4)	—	(.9)	—	(2.3)
Remaining reserve at December 31, 1998	2.6	—	1.6	—	4.2
1999 restructuring charges	1.5	.2	(.4)	.1	1.4
Amounts utilized during 1999	(1.0)	(.2)	(.6)	(.1)	(1.9)
Remaining reserve at December 31, 1999	\$3.1	\$ —	\$.6	\$ —	\$3.7

(a) Includes approximately \$32 of pension and postretirement health care curtailment losses and special termination benefits recognized in 1999. Refer to Notes 9 and 10.

(b) Includes approximately \$18 and \$4 of pension and postretirement health care curtailment losses and special termination benefits recognized in 1998 and 1999, respectively. Refer to Notes 9 and 10.

North American overhead activity analysis	Employee retirement & severance benefits (b)	Asset write-offs	Asset removal	Other costs (d)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1996	\$ —	\$ —	\$ —	\$ —	\$ —
1997 restructuring charges	—	—	—	—	—
Amounts utilized during 1997	—	—	—	—	—
Remaining reserve at December 31, 1997	—	—	—	—	—
1998 restructuring charges	57.1	5.2	3.0	1.8	67.1
Amounts utilized during 1998	(22.7)	(5.2)	(.1)	(1.8)	(29.8)
Remaining reserve at December 31, 1998	34.4	—	2.9	—	37.3
1999 restructuring charges	5.5	—	1.1	4.5	11.1
Amounts utilized during 1999	(35.7)	—	(3.0)	(4.5)	(43.2)
Remaining reserve at December 31, 1999	\$ 4.2	\$ —	\$ 1.0	\$ —	\$ 5.2

All other	Employee retirement & severance benefits	Asset write-offs	Asset removal	Other costs (d)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1996	\$ 2.2	\$ —	\$ —	\$ —	\$ 2.2
1997 restructuring charges	.1	.6	.6	.5	1.8
Amounts utilized during 1997	(2.1)	(.6)	—	(.5)	(3.2)
Remaining reserve at December 31, 1997	.2	—	.6	—	.8
1998 restructuring charges	2.7	.3	—	.4	3.4
Amounts utilized during 1998	(2.1)	(.3)	(.3)	(.4)	(3.1)
Remaining reserve at December 31, 1998	.8	—	.3	—	1.1
1999 restructuring charges	4.8	11.7	—	—	16.5
Amounts utilized during 1999	(5.6)	(11.7)	(.3)	—	(17.6)
Remaining reserve at December 31, 1999	\$ —	\$ —	\$ —	\$ —	\$ —

Consolidated	Employee retirement & severance benefits (a) (b)	Asset write-offs	Asset removal	Other costs (d)	Total
<i>(millions)</i>					
Remaining reserve at December 31, 1996	\$23.9	\$ —	\$30.4	\$ —	\$ 54.3
1997 restructuring charges	22.4	78.1	19.3	41.3	161.1
Amounts utilized during 1997	(22.7)	(78.1)	(21.4)	(41.3)	(163.5)
Remaining reserve at December 31, 1997	23.6	—	28.3	—	51.9
1998 restructuring charges	59.8	5.5	3.0	2.2	70.5
Amounts utilized during 1998	(43.8)	(5.5)	(19.4)	(2.2)	(70.9)
Remaining reserve at December 31, 1998 (c)	39.6	—	11.9	—	51.5
1999 restructuring charges	78.2	131.2	29.5	5.7	244.6
Amounts utilized during 1999	(86.4)	(131.2)	(12.9)	(5.7)	(236.2)
Remaining reserve at December 31, 1999 (c)	\$31.4	\$ —	\$28.5	\$ —	\$ 59.9

(c) Negative removal reserves in Europe result from netting of anticipated proceeds from asset sales with removal costs.

(d) Consist primarily of program-related non-exit costs incurred during the period of the reported charge.

Incremental pretax savings achieved or expected from streamlining initiatives by year, and the relative impact on captions within the Consolidated Statement of Earnings, are:

(millions)	Incremental pretax savings	Relative impact on	
		Cost of goods sold	SGA (a)
1997	\$ 60	75%	25%
1998	10	75%	25%
1999	125	10%	90%
2000 expected	50	80%	20%

(a) Selling, general, and administrative expense.

Total cash outlays incurred or expected for streamlining initiatives by year are:

(millions)	
1997	\$85
1998	47
1999	69
2000 expected	60

Asset impairment losses

During 1997, the Company included in operating profit \$23.0 million of asset impairment losses, resulting from evaluation of the Company's ability to recover components of its investments, based on management's ongoing strategic assessment of local conditions, in the emerging markets of Asia-Pacific. These investments consist of cereal manufacturing plant, property, and equipment located in India and China. In both of these markets, demand for the Company's locally produced products has fallen short of expectations during the initial years of operation. As of year-end 1997, the future cash flows expected to be generated from these operations were not projected to support the current carrying value of the manufacturing assets during their remaining useful lives. Therefore, pursuant to SFAS No. 121 "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of," management reduced the carrying value of these assets to fair market value. Fair market value was based on independent real estate appraisal in the case of plant and property, and internal engineering evaluations in the case of equipment. These assets are currently being held and used with no plans for future disposal. Management is implementing new strategies in these markets that leverage the Company's ability to appeal to local tastes.

2000 events

The Company's streamlining initiatives will continue in 2000. The Company expects to implement streamlining initiatives in its European supply chain as part of an ongoing efficiency program. As a result of this action, the Company expects to record pretax restructuring charges of approximately \$25 million in the second quarter of 2000.

Note 4 Other income (expense), net

Other income (expense), net includes non-operating items such as interest income, foreign exchange gains and losses, and charitable donations.

Other income (expense), net for 1998 includes a credit of approximately \$6 million related to settlement of certain litigation. During 1996, the Company included in operating profit a provision of \$15 million for the potential settlement of this litigation, which brought the total settlement reserve to \$18 million. This litigation was settled during the second quarter of 1998 for a cost of approximately \$12 million, and the remaining reserve of approximately \$6 million was reversed.

Note 5 Equity

Earnings per share

Basic net earnings per share is determined by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per share is similarly determined, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all dilutive potential common shares had been issued. Dilutive potential common shares are comprised principally of employee stock options issued by the Company and had an insignificant impact on earnings per share during the periods presented. Basic net earnings per share is reconciled to diluted net earnings per share as follows:

(millions, except per share data)	Net earnings	Average shares outstanding	Net earnings per share
1999			
Basic	\$338.3	405.2	\$.83
Dilutive employee stock options	—	.5	—
Diluted	\$338.3	405.7	\$.83
1998			
Basic	\$502.6	407.8	\$1.23
Dilutive employee stock options	—	.8	—
Diluted	\$502.6	408.6	\$1.23
1997			
Basic	\$546.0	414.1	\$1.32
Dilutive employee stock options	—	1.1	—
Diluted	\$546.0	415.2	\$1.32

Comprehensive Income

Comprehensive income includes all changes in equity during a period except those resulting from investments by or distributions to shareholders. For the Company, comprehensive income for the periods presented consists solely of net earnings and foreign currency translation adjustments pursuant to SFAS No. 52 "Foreign Currency Translation" as follows:

(millions)	1999	1998	1997
Net earnings	\$338.3	\$502.6	\$546.0
Other comprehensive income:			
Foreign currency translation adjustments	(39.0)	(11.1)	(112.1)
Related tax effect	—	.6	(3.5)
	(39.0)	(10.5)	(115.6)
Total comprehensive income	\$299.3	\$492.1	\$430.4

Note 6 Leases

Operating leases are generally for equipment and warehouse space. Rent expense on all operating leases was \$31.5 million in 1999, \$36.5 million in 1998, and \$38.6 million in 1997. At December 31, 1999, future minimum annual rental commitments under non-cancelable operating leases totaled \$53 million consisting of (in millions): 2000-\$14; 2001-\$11; 2002-\$8; 2003-\$7; 2004-\$5; 2005 and beyond-\$8.

Note 7 Debt

Notes payable consist of commercial paper borrowings in the United States at the highest credit rating available, borrowings against a revolving credit agreement in Europe and, to a lesser extent, bank loans of foreign subsidiaries at competitive market rates. U.S. borrowings at December 31, 1999, were \$448.3 million with an effective interest rate of 5.9%. U.S. borrowings at December 31, 1998, were \$423.3 million with an effective interest rate of 5.2%. Associated with these borrowings, during September 1997, the

Company purchased a \$225 million notional, four-year fixed interest rate cap. Under the terms of the cap, if the Federal Reserve AA composite rate on 30-day commercial paper increased to 6.33%, the Company would pay this fixed rate on \$225 million of its commercial paper borrowings. If the rate increased to 7.68% or above, the cap would expire. The Company sold this cap in November 1999; proceeds were insignificant.

In December 1998, the Company entered into a \$200 million, three-year revolving credit agreement with several international banks. At December 31, 1999, outstanding borrowings under this agreement were \$16.2 million with an effective interest rate of 5.6%. At December 31, 1998, outstanding borrowings under this agreement were \$148.5 million with an effective interest rate of 5.5%. Additionally, the Company has entered into financing arrangements that provide for the sale of future foreign currency revenues. As of December 31, 1999, the Company had committed to borrowings during 2000 in the cumulative principal amount of approximately \$366 million. No borrowings were outstanding under these arrangements at December 31, 1999 or 1998. At December 31, 1999, the Company had \$718.2 million of total short-term lines of credit, of which \$626.3 million were unused and available for borrowing on an unsecured basis.

Long-term debt at year-end consisted of:

(millions)	1999	1998
(a) Seven-Year Notes due 2005	\$ 200.0	\$ 200.0
(b) Seven-Year Notes due 2004	500.0	500.0
(c) Four-Year Notes due 2001	500.0	500.0
(d) Three-Year Notes due 2001	400.0	400.0
Other	15.7	15.6
	1,615.7	1,615.6
Less current maturities	(2.9)	(1.1)
Balance, December 31	\$1,612.8	\$1,614.5

(a) In October 1998, the Company issued \$200 of seven-year 4.875% fixed rate U.S. Dollar Notes to replace maturing long-term debt. The Company entered into a series of interest rate hedges throughout 1998 to effectively fix the interest rate prior to issuance. The effect of the hedges, when combined with original issue discounts, resulted in an effective interest rate on this debt of 6.07%.

(b) In January 1997, the Company issued \$500 of seven-year 6.625% fixed rate Euro Dollar Notes. In conjunction with this issuance, the Company settled \$500 notional amount of interest rate forward swap agreements, which effectively fixed the interest rate on the debt at 6.354%. Associated with this debt, during September 1997, the Company entered into a \$225 notional, 4 1/2-year fixed-to-floating interest rate swap, indexed to the three-month London Interbank Offered Rate (LIBOR). Under the terms of this swap, if three-month LIBOR decreased to 4.71% or below, the swap would expire. The Company terminated this swap agreement in November 1999. The amount paid to discharge the agreement was insignificant.

(c) In August 1997, the Company issued \$500 of four-year 6.125% Euro Dollar Notes. In conjunction with this issuance, the Company settled \$400 notional amount of interest rate forward swap agreements that effectively fixed the interest rate on the debt at 6.4%. Associated with this debt, during September 1997, the Company entered into a \$200 notional, four-year fixed-to-floating interest rate swap, indexed to three-month LIBOR.

(d) In February 1998, the Company issued \$400 of three-year 5.75% fixed rate U.S. Dollar Notes. These Notes were issued under an existing "shelf registration" with the Securities and Exchange Commission, and provide an option to holders to extend the obligation for an additional four years at a predetermined interest rate of 5.63% plus the Company's then-current credit spread. As a result of this option, the effective interest rate on the three-year Notes is 5.23%. Concurrent with this issuance, the Company entered into a \$400 notional, three-year fixed-to-floating interest rate swap, indexed to the Federal Reserve AA Composite Rate on 30-day commercial paper.

Scheduled principal repayments on long-term debt are (in millions): 2000-\$3; 2001-\$900; 2002-\$4; 2003-\$1; 2004-\$500; 2005 and beyond-\$208.

Interest paid was (in millions): 1999-\$124; 1998-\$113; 1997-\$85. Interest expense capitalized as part of the construction cost of fixed assets was (in millions): 1999-\$8.4; 1998-\$7.8; 1997-\$9.6.

Note 8 Stock options

The Key Employee Long Term Incentive Plan provides for benefits to be awarded to executive-level employees in the form of stock options, performance shares, performance units, incentive stock options, restricted stock grants, and other stock-based awards. Options granted under this plan generally vest over two years and, prior to September 1997, vested at the date of grant. The Bonus Replacement Stock Option Plan allows certain key executives to receive stock options that generally vest immediately in lieu of part or all of their respective bonus. Options granted under this plan are issued from the Key Employee Long Term Incentive Plan. The Kellogg Employee Stock Ownership Plan is designed to offer stock and other incentive awards based on Company performance to employees who are not eligible to participate in the Key Employee Long Term Incentive Plan. Options awarded under the Kellogg Employee Stock Ownership Plan are subject to graded vesting over a five-year period. Under these plans (the "stock option plans"), options are granted with exercise prices equal to the fair market value of the Company's common stock at the time of grant, exercisable for a 10-year period following the date of grant, subject to vesting rules.

The Key Employee Long Term Incentive Plan contains an accelerated ownership feature ("AOF"). An AOF option is granted when Company stock is surrendered to pay the exercise price of a stock option. The holder of the option is granted an AOF option for the number of shares surrendered. For all AOF options, the original expiration date is not changed but the options vest immediately.

As permitted by SFAS #123 "Accounting for Stock-Based Compensation," the Company has elected to account for the stock option plans under APB #25 "Accounting for Stock Issued to Employees." Accordingly, no compensation cost has been recognized for these plans.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. Had compensation cost for the stock option plans been determined based on the fair value at the grant date consistent with SFAS #123, the Company's net earnings and earnings per share are estimated as follows:

(millions, except per share data)	1999	1998	1997
Net earnings			
As reported	\$338.3	\$502.6	\$546.0
Pro forma	\$311.4	\$484.4	\$520.8
Net earnings per share (basic and diluted)			
As reported	\$.83	\$ 1.23	\$ 1.32
Pro forma	\$.77	\$ 1.19	\$ 1.26

The fair value of each option grant was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	1999	1998	1997
Risk-free interest rate	4.83%	5.56%	6.31%
Dividend yield	3.00%	2.00%	1.97%
Volatility	23.16%	21.28%	19.83%
Average expected term (years)	3.76	3.47	3.52
Fair value of options granted	\$6.38	\$8.45	\$7.48

Transactions under these plans were:

(millions, except per share data)	1999	1998	1997
Under option, January 1	16.4	12.4	11.2
Granted	6.6	6.8	6.0
Exercised	(1.1)	(1.7)	(4.5)
Cancelled	(2.0)	(1.1)	(.3)
Under option, December 31	19.9	16.4	12.4
Exercisable, December 31	10.1	8.7	8.1
Shares available, December 31, for options that may be granted under the following plans:			
Key Employee Long Term Incentive Plan	7.1	9.8	13.2
Kellogg Employee Stock Ownership Plan	4.6	6.0	6.9
Total shares available, December 31, for options that may be granted	11.7	15.8	20.1
Average prices per share			
Under option, January 1	\$38	\$35	\$33
Granted	36	43	36
Exercised	32	34	33
Cancelled	39	33	34
Under option, December 31	\$38	\$38	\$35
Exercisable, December 31	\$39	\$36	\$36

Employee stock options outstanding and exercisable under these plans as of December 31, 1999, were:

(millions, except per share data)	Outstanding			Exercisable	
	Range of exercise prices	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	\$15-34	7.6	\$33	2.5	\$30
	35-39	5.4	38	2.9	38
	40-44	6.2	43	4.0	43
	45-50	.7	48	.7	48
		19.9		10.1	

Note 9 Pension benefits

The Company has a number of U.S. and foreign pension plans to provide retirement benefits for its employees. Benefits for salaried employees are generally based on salary and years of service, while union employee benefits are generally a negotiated amount for each year of service. Plan funding strategies are influenced by tax regulations. Plan assets consist primarily of equity securities with smaller holdings of bonds, real estate, and other investments. Investment in Company common stock represented 1.9% and 2.4% of consolidated plan assets at December 31, 1999 and 1998, respectively.

The components of pension expense were:

(millions)	1999	1998	1997
Service cost	\$ 42.6	\$ 41.3	\$ 29.9
Interest cost	83.7	81.3	79.6
Expected return on plan assets	(125.1)	(113.9)	(104.7)
Amortization of unrecognized transition obligation	2.0	.7	(.3)
Amortization of unrecognized prior service cost	7.4	7.5	7.9
Recognized net losses	10.9	10.0	4.7
Curtailment loss and special termination benefits	33.5	17.4	—
Pension expense – Company plans	55.0	44.3	17.1
Pension expense – multiemployer plans	1.4	1.2	1.9
Total pension expense	\$ 56.4	\$ 45.5	\$ 19.0

The worldwide weighted average actuarial assumptions were:

	1999	1998	1997
Discount rate	7.2%	6.7%	7.6%
Long-term rate of compensation increase	4.2%	4.9%	4.9%
Long-term rate of return on plan assets	10.4%	10.5%	10.5%

The aggregate change in projected benefit obligation, change in plan assets, and funded status were:

(millions)	1999	1998
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	\$1,331.2	\$1,133.4
Service cost	42.6	41.3
Interest cost	83.7	81.3
Plan participants' contributions	1.3	1.4
Amendments	36.6	9.6
Actuarial (gain)/loss	(58.4)	133.6
Benefits paid	(76.1)	(70.5)
Other	(10.5)	1.1
Projected benefit obligation at end of year	\$1,350.4	\$1,331.2
Change in plan assets		
Fair value of plan assets at beginning of year	\$1,318.3	\$1,209.0
Actual return on plan assets	299.8	132.6
Employer contribution	42.9	54.7
Plan participants' contributions	1.3	1.4
Benefits paid	(76.1)	(70.5)
Other	(8.2)	(8.9)
Fair value of plan assets at end of year	\$1,578.0	\$1,318.3
Funded status		
	\$ 227.6	(\$ 12.9)
Unrecognized net (gain)/loss	(135.4)	111.5
Unrecognized transition amount	3.4	4.2
Unrecognized prior service cost	38.4	36.2
Prepaid pension	\$ 134.0	\$ 139.0
Amounts recognized in the statement of financial position consist of		
Prepaid benefit cost	\$ 207.9	\$ 213.6
Accrued benefit liability	(86.9)	(88.4)
Intangible asset	13.0	13.8
Net amount recognized	\$ 134.0	\$ 139.0

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for pension plans with accumulated benefit obligations in excess of plan assets were:

(millions)	1999	1998
Projected benefit obligation	\$89.7	\$104.6
Accumulated benefit obligation	76.1	84.5
Fair value of plan assets	—	8.3

All gains and losses, other than curtailment losses and special termination benefits, are recognized over the average remaining service period of active plan participants. Curtailment losses and special termination benefits recognized in 1999 and 1998 were recorded as a component of restructuring charges. Refer to Note 3 for further information.

Certain of the Company's subsidiaries sponsor 401(k) or similar savings plans for active employees. Expense related to these plans was (in millions): 1999-\$17; 1998-\$16; 1997-\$16.

Note 10 Nonpension postretirement benefits

Certain of the Company's North American subsidiaries provide health care and other benefits to substantially all retired employees, their covered dependents, and beneficiaries. Generally, employees are eligible for these benefits when one of the following service/age requirements is met: 30 years and any age; 20 years and age 55; 5 years and age 62. Plan assets consist primarily of equity securities with smaller holdings of bonds.

Components of postretirement benefit expense were:

(millions)	1999	1998	1997
Service cost	\$ 9.3	\$ 9.1	\$ 9.6
Interest cost	37.4	36.8	37.2
Expected return on plan assets	(17.8)	(15.0)	(13.3)
Amortization of unrecognized prior service cost	(.5)	(.5)	(.5)
Recognized net gains	(4.8)	(5.3)	(6.3)
Curtailment loss and special termination benefits	.5	1.0	—
Post retirement benefit expense	\$24.1	\$26.1	\$26.7

The weighted average actuarial assumptions were:

	1999	1998	1997
Discount rate	8.0%	7.0%	7.25%
Long-term rate of return on plan assets	10.5%	10.5%	10.5%

The aggregate change in accumulated postretirement benefit obligation, change in plan assets, and funded status were:

(millions)	1999	1998
Change in accumulated benefit obligation		
Accumulated benefit obligation at beginning of year	\$548.8	\$523.3
Service cost	9.3	9.1
Interest cost	37.4	36.8
Actuarial loss	15.3	7.6
Amendments	(.2)	2.2
Benefits paid	(30.6)	(29.5)
Other	.2	(.7)
Accumulated benefit obligation at end of year	\$580.2	\$548.8
Change in plan assets		
Fair value of plan assets at beginning of year	\$177.4	\$150.7
Actual return on plan assets	48.0	22.1
Employer contribution	35.2	34.1
Benefits paid	(30.6)	(29.5)
Fair value of plan assets at end of year	\$230.0	\$177.4
Funded status		
	(\$350.2)	(\$371.4)
Unrecognized net gain	(88.9)	(80.9)
Unrecognized prior service cost	(10.7)	(6.2)
Accrued post retirement benefit cost	(\$449.8)	(\$458.5)
Amounts recognized in the statement of financial position consist of		
Accrued benefit liability	(\$449.8)	(\$458.5)

The assumed health care cost trend rate was 6% for 1999, decreasing gradually to 5% by the year 2003 and remaining at that level thereafter. These trend rates reflect the Company's prior experience and management's

expectation that future rates will decline. A one percentage point change in assumed health care cost trend rates would have the following effects:

(millions)	One percentage point increase	One percentage point decrease
Effect on total of service and interest cost components	\$ 6.8	(\$ 5.6)
Effect on postretirement benefit obligation	\$70.4	(\$58.5)

All gains and losses, other than curtailment losses and special termination benefits, are recognized over the average remaining service period of active plan participants. The net curtailment loss and special termination benefits for 1999 include a \$2.2 million loss recorded as a component of restructuring charges and a \$1.7 million gain recorded as a component of disposition-related charges. The net curtailment loss and special termination benefits for 1998 were recorded as a component of restructuring charges. Refer to Notes 2 and 3 for further information. Since December 1996, the Company has contributed to a voluntary employee benefit association (VEBA) trust for funding of its nonpension postretirement benefit obligations.

Note 11 Income taxes

Earnings before income taxes and cumulative effect of accounting change, and the provision for U.S. federal, state, and foreign taxes on these earnings, were:

(millions)	1999	1998	1997
Earnings before income taxes and cumulative effect of accounting change			
United States	\$235.1	\$564.0	\$576.4
Foreign	301.6	218.5	328.1
	\$536.7	\$782.5	\$904.5
Income Taxes			
Currently payable			
Federal	\$135.9	\$128.7	\$129.4
State	20.6	17.8	29.6
Foreign	102.4	87.2	143.0
	258.9	233.7	302.0
Deferred			
Federal	(60.7)	30.6	50.2
State	(4.5)	1.7	4.0
Foreign	4.7	13.9	(15.7)
	(60.5)	46.2	38.5
Total income taxes	\$198.4	\$279.9	\$340.5

The difference between the U.S. federal statutory tax rate and the Company's effective rate was:

	1999	1998	1997
U.S. statutory rate	35.0%	35.0%	35.0%
Foreign rate varying from 35%	(.5)	(2.0)	(1.6)
State income taxes, net of federal benefit	2.0	2.4	2.4
Net change in valuation allowances	(1.3)	2.9	1.6
Statutory rate changes, deferred tax impact	(.6)	(.3)	(.5)
Other	2.4	(2.2)	.7
Effective income tax rate	37.0%	35.8%	37.6%

The changes in valuation allowances on deferred tax assets and corresponding impacts on the effective income tax rate, as presented above, result primarily from management's assessment of the Company's ability to utilize certain operating loss and tax credit carryforwards. Total tax benefits of carryforwards at year-end 1999 and 1998 were \$43.2 million and \$55.3 million, respectively, and expire principally after five years.

The deferred tax assets and liabilities included in the balance sheet at year-end were:

(millions)	Deferred tax assets		Deferred tax liabilities	
	1999	1998	1999	1998
Current				
Promotion and advertising	\$ 18.0	\$ 26.0	\$ 7.4	\$ 9.9
Wages and payroll taxes	17.3	27.3	—	—
Inventory valuation	9.6	6.1	11.4	11.6
Health and postretirement benefits	34.3	18.1	.3	3.8
State taxes	6.7	5.7	—	—
Operating loss and credit carryforwards	1.5	1.7	—	—
Other	35.0	21.9	7.1	4.4
	122.4	106.8	26.2	29.7
Less valuation allowance	(2.2)	(1.5)	—	—
	120.2	105.3	26.2	29.7
Noncurrent				
Depreciation and asset disposals	16.7	15.7	291.9	327.1
Health and postretirement benefits	158.9	164.3	68.9	58.8
Capitalized interest	—	—	24.0	28.3
State taxes	1.6	—	—	1.9
Operating loss and credit carryforwards	41.7	53.6	—	—
Trademarks	—	2.5	29.8	—
Other	32.2	19.4	14.4	17.5
	251.1	255.5	429.0	433.6
Less valuation allowance	(59.6)	(67.1)	—	—
	191.5	188.4	429.0	433.6
Total deferred taxes	\$311.7	\$293.7	\$455.2	\$463.3

At December 31, 1999, foreign subsidiary earnings of \$1.3 billion were considered permanently invested in those businesses. Accordingly, U.S. income taxes have not been provided on these earnings. Foreign withholding taxes of approximately \$82 million would be payable upon remittance of these earnings. Subject to certain limitations, the withholding taxes would then be available for use as credits against the U.S. tax liability.

Cash paid for income taxes was (in millions): 1999-\$242; 1998-\$211; 1997-\$332.

Note 12 Financial instruments and credit risk concentration

The fair values of the Company's financial instruments are based on carrying value in the case of short-term items, quoted market prices for derivatives and investments, and, in the case of long-term debt, incremental borrowing rates currently available on loans with similar terms and maturities. The carrying amounts of the Company's cash, cash equivalents, receivables, notes payable, and long-term debt approximate fair value.

The Company is exposed to certain market risks which exist as a part of its ongoing business operations and uses derivative financial and commodity instruments, where appropriate, to manage these risks. In general, instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the contract. Deferred gains or losses related to any instrument 1) designated but ineffective as a hedge of existing assets, liabilities, or firm commitments, or 2) designated as a hedge of an anticipated transaction which is no longer likely to occur, are recognized immediately in the statement of earnings.

For all derivative financial and commodity instruments held by the Company, changes in fair values of these instruments and the resultant impact on the Company's cash flows and/or earnings would generally be offset by changes

in value of underlying exposures. The impact on the Company's results and financial position of holding derivative financial and commodity instruments was insignificant during the periods presented.

Foreign exchange risk

The Company is exposed to fluctuations in foreign currency cash flows related primarily to third-party purchases, intercompany product shipments, and intercompany loans. The Company is also exposed to fluctuations in the value of foreign currency investments in subsidiaries and cash flows related to repatriation of these investments. Additionally, the Company is exposed to volatility in the translation of foreign currency earnings to U.S. Dollars.

The Company assesses foreign currency risk based on transactional cash flows and enters into forward contracts and other commitments to sell foreign currency revenues, all of generally less than twelve months duration, to reduce fluctuations in net long or short currency positions. Foreign currency contracts are marked-to-market with net amounts due to or from counterparties recorded in accounts receivable or payable. For contracts hedging firm commitments, mark-to-market gains and losses are deferred and recognized as adjustments to the basis of the transaction. For contracts hedging subsidiary investments, mark-to-market gains and losses are recorded in the accumulated other comprehensive income component of shareholders' equity. For all other contracts, mark-to-market gains and losses are recognized currently in other income or expense. Commitments to sell future foreign currency revenues are accounted for as contingent borrowings.

The notional amounts of open forward contracts were \$3.8 million and \$22.2 million at December 31, 1999 and 1998, respectively. No borrowings were outstanding under commitments to sell foreign currency revenues at December 31, 1999 or 1998. Refer to Supplemental Financial Information on pages 35 and 36 for further information regarding these contracts.

Interest rate risk

The Company is exposed to interest rate volatility with regard to future issuances of fixed rate debt and existing issuances of variable rate debt. The Company uses interest rate caps, and currency and interest rate swaps, including forward swaps, to reduce interest rate volatility and funding costs associated with certain debt issues, and to achieve a desired proportion of variable versus fixed rate debt, based on current and projected market conditions.

Interest rate forward swaps are marked-to-market with net amounts due to or from counterparties recorded in interest receivable or payable. Mark-to-market gains and losses are deferred and recognized over the life of the debt issue as a component of interest expense. For other caps and swaps entered into concurrently with the debt issue, the interest or currency differential to be paid or received on the instrument is recognized in the statement of earnings as incurred, as a component of interest expense. If a position were to be terminated prior to maturity, the gain or loss realized upon termination would be deferred and amortized to interest expense over the remaining term of the underlying debt issue or would be recognized immediately if the underlying debt issue were settled prior to maturity.

The notional amounts of currency and interest rate swaps and caps were \$600.0 million and \$1.05 billion at December 31, 1999 and 1998, respectively. Refer to Note 7 and Supplemental Financial Information on pages 35 and 36 for further information regarding these swaps.

Price risk

The Company is exposed to price fluctuations primarily as a result of anticipated purchases of raw and packaging materials. The Company uses the combination of long cash positions with suppliers, and exchange-traded futures and option contracts to reduce price fluctuations in a desired percentage of forecasted purchases over a duration of generally less than one year. Commodity contracts are marked-to-market with net amounts due to or from brokers recorded in accounts receivable or payable. Mark-to-market gains and losses are deferred and recognized as adjustments to the basis of the underlying material purchase.

Credit risk concentration

The Company is exposed to credit loss in the event of nonperformance by counterparties on derivative financial and commodity contracts. This credit loss is limited to the cost of replacing these contracts at current market rates. Management believes that the probability of such loss is remote.

Financial instruments which potentially subject the Company to concentrations of credit risk are primarily cash, cash equivalents, and accounts receivable. The Company places its investments in highly rated financial institutions and investment grade short-term debt instruments, and limits the amount of credit exposure to any one entity. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers, generally short payment terms, and their dispersion across geographic areas.

Note 13 Quarterly financial data (unaudited)

(millions, except per share data)	Net sales		Gross profit	
	1999	1998	1999	1998
First	\$1,745.3	\$1,642.9	\$ 908.9	\$ 861.1
Second	1,784.4	1,713.5	946.1	893.9
Third	1,868.4	1,805.8	984.7	936.9
Fourth	1,586.1	1,599.9	819.4	787.6
	\$6,984.2	\$6,762.1	\$3,659.1	\$3,479.5
	Net earnings (a)		Net earnings per share (a)(b)	
	1999	1998	1999	1998
First	\$ 118.8	\$ 170.7	\$.29	\$.42
Second	154.2	143.2	.38	.35
Third	(35.6)	141.9	(.08)	.35
Fourth	100.9	46.8	.25	.11
	\$ 338.3	\$ 502.6		

(a) The quarterly results of 1999 and 1998 include the following restructuring and disposition-related charges. Refer to Notes 2 and 3 for further information.

	Net earnings		Net earnings per share (b)	
	1999	1998	1999	1998
First	(\$ 25.6)	\$ —	(\$.07)	\$ —
Third	(206.4)	—	(.50)	—
Fourth	(35.9)	(46.3)	(.09)	(.12)
	(\$267.9)	(\$46.3)		

(b) Earnings per share presented represent both basic and diluted earnings per share.

The principal market for trading Kellogg shares is the New York Stock Exchange (NYSE). The shares are also traded on the Boston, Chicago, Cincinnati, Pacific, and Philadelphia Stock Exchanges. At year-end 1999, the closing price (on the NYSE) was \$30 13/16 and there were 47,511 shareholders of record. The reported number of shareholders increased from 24,634 in 1998 due to the first-time inclusion of participants in the Kellogg Company Dividend Reinvestment Plan. The comparable number of shareholders of record for 1998 was 47,333.

Dividends paid and the quarterly price ranges on the NYSE during the last two years were:

1999 – Quarter	Dividend	Stock price	
		High	Low
Fourth	\$.245	\$40.94	\$30.00
Third	.245	39.00	31.50
Second	.235	38.13	31.38
First	.235	42.25	33.69
	\$.960		
1998 – Quarter			
Fourth	\$.235	\$37.63	\$32.19
Third	.235	39.19	29.56
Second	.225	43.50	37.69
First	.225	49.69	41.81
	\$.920		

Note 14 Operating segments

Kellogg Company is the world's leading producer of ready-to-eat cereal and a leading producer of convenience foods, including toaster pastries, cereal bars, frozen waffles, and meat alternatives. Principal markets for these products include the United States and United Kingdom. Operations are managed via four major geographic areas – North America, Europe, Asia-Pacific, and Latin America – which are the basis of the Company's reportable operating segment information disclosed below. The measurement of operating segment results is generally consistent with the presentation of the Consolidated Statement of Earnings and Balance Sheet. Intercompany transactions between reportable operating segments were insignificant in all periods presented.

(millions)	1999	1998	1997
Net sales			
North America	\$4,358.3	\$4,175.9	\$4,260.8
Europe	1,614.4	1,698.5	1,702.0
Asia-Pacific	442.0	377.0	411.9
Latin America	567.0	510.7	455.4
Corporate and other	2.5	—	—
Consolidated	\$6,984.2	\$6,762.1	\$6,830.1
Operating profit excluding charges (a)			
North America	\$ 866.7	\$ 831.6	\$ 884.8
Europe	224.1	211.4	305.8
Asia-Pacific	53.2	48.3	51.1
Latin America	141.3	107.2	111.8
Corporate and other	(211.9)	(232.9)	(160.3)
Consolidated	1,073.4	965.6	1,193.2
Charges (a)	(244.6)	(70.5)	(184.1)
Operating profit as reported	\$ 828.8	\$ 895.1	\$1,009.1
Charges (a)			
North America	\$ 197.9	\$ 40.8	\$ 37.8
Europe	22.4	3.3	115.9
Asia-Pacific	4.6	3.4	28.6
Latin America	1.7	—	.2
Corporate and other	18.0	23.0	1.6
Consolidated	\$ 244.6	\$ 70.5	\$ 184.1
Depreciation and amortization			
North America	\$ 151.3	\$ 152.1	\$ 153.7
Europe	57.8	54.6	59.6
Asia-Pacific	22.5	21.3	21.9
Latin America	14.5	14.2	12.5
Corporate and other	41.9	35.9	39.6
Consolidated	\$ 288.0	\$ 278.1	\$ 287.3
Interest expense			
North America	\$.3	\$.5	\$.3
Europe	9.3	4.4	1.9
Asia-Pacific	—	.1	.6
Latin America	.6	.9	1.0
Corporate and other	108.6	113.6	104.5
Consolidated	\$ 118.8	\$ 119.5	\$ 108.3
Income taxes excluding charges (b)			
North America	\$ 232.1	\$ 224.8	\$ 258.3
Europe	28.8	37.0	80.5
Asia-Pacific	9.5	7.3	12.1
Latin America	34.4	28.1	21.0
Corporate and other	38.8	6.9	12.2
Consolidated	\$ 343.6	\$ 304.1	\$ 384.1
Effect of charges (b)	(145.2)	(24.2)	(43.6)
Income taxes as reported	\$ 198.4	\$ 279.9	\$ 340.5

continued

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(millions)	1999	1998	1997
Total assets			
North America	\$2,478.1	\$2,430.8	\$2,519.2
Europe	1,157.3	1,336.0	1,154.5
Asia-Pacific	378.3	328.4	309.5
Latin America	414.3	380.9	361.4
Corporate and other	1,755.9	1,516.7	1,405.1
Elimination entries	(1,375.2)	(941.3)	(872.1)
Consolidated	\$4,808.7	\$5,051.5	\$4,877.6
Additions to long-lived assets			
North America	\$ 465.8	\$ 82.5	\$ 166.5
Europe	67.4	169.1	60.7
Asia-Pacific	26.9	40.3	24.3
Latin America	47.4	41.7	43.3
Corporate and other	41.7	98.5	94.9
Consolidated	\$ 649.2	\$ 432.1	\$ 389.7

(a) Charges include restructuring charges in 1999 and 1998, and restructuring and asset impairment charges in 1997. Refer to Note 3 for further information.

(b) Charges include those described in (a) plus disposition-related charges reported in earnings before income taxes. Refer to Note 2 for further information.

Supplemental geographic information is provided below for revenues from external customers and long-lived assets:

(millions)	1999	1998	1997
Net sales			
United States	\$4,014.1	\$3,858.0	\$3,922.2
United Kingdom	689.3	743.6	719.0
Other foreign countries	2,280.8	2,160.5	2,188.9
Consolidated	\$6,984.2	\$6,762.1	\$6,830.1
Long-lived assets			
United States	\$1,549.3	\$1,644.2	\$1,707.1
United Kingdom	552.3	553.0	452.4
Other foreign countries	1,110.3	1,330.3	1,225.2
Consolidated	\$3,211.9	\$3,527.5	\$3,384.7

Supplemental product information is provided below for revenues from external customers:

(millions)	1999	1998	1997
Ready-to-eat cereal net sales	\$5,304.7	\$5,265.4	\$5,435.8
Convenience foods net sales	1,679.5	1,496.7	1,394.3
Consolidated	\$6,984.2	\$6,762.1	\$6,830.1

Note 15 Supplemental financial statement data

(millions)

Consolidated Statement of Earnings	1999	1998	1997
Research and development expense	\$ 104.1	\$ 121.9	\$106.1
Advertising expense	\$ 674.1	\$ 695.3	\$780.4

Consolidated Statement of Cash Flows	1999	1998	1997
Accounts receivable	\$ 21.0	(\$ 102.6)	\$ 5.1
Inventories	(39.1)	(15.0)	(8.1)
Other current assets	14.7	33.2	(11.0)
Accounts payable	(84.8)	58.9	(8.7)
Other current liabilities	(58.6)	(76.8)	1.9
Changes in operating assets and liabilities	(\$ 146.8)	(\$ 102.3)	(\$ 20.8)

Consolidated Balance Sheet	1999	1998
Trade receivables	\$ 561.5	\$ 555.2
Allowance for doubtful accounts	(8.6)	(12.9)
Other receivables	125.6	150.7
Accounts receivable, net	\$ 678.5	\$ 693.0
Raw materials and supplies	\$ 141.2	\$ 133.3
Finished goods and materials in process	362.6	318.1
Inventories	\$ 503.8	\$ 451.4
Deferred income taxes	\$ 108.5	\$ 89.9
Other prepaid assets	127.8	125.8
Other current assets	\$ 236.3	\$ 215.7
Land	\$ 44.1	\$ 49.3
Buildings	1,255.3	1,247.9
Machinery and equipment	3,595.5	3,608.2
Construction in progress	261.8	341.4
Accumulated depreciation	(2,515.8)	(2,358.0)
Property, net	\$2,640.9	\$2,888.8
Goodwill	\$ 205.1	\$ 197.0
-Accumulated amortization	(4.4)	(11.5)
Other intangibles	144.5	215.9
-Accumulated amortization	(9.6)	(21.9)
Other assets	263.0	286.7
Other assets	\$ 598.6	\$ 666.2
Accrued income taxes	\$ 83.5	\$ 69.4
Accrued salaries and wages	126.0	100.7
Accrued advertising and promotion	211.8	243.4
Other	339.7	296.6
Other current liabilities	\$ 761.0	\$ 710.1
Nonpension postretirement benefits	\$ 424.9	\$ 435.2
Deferred income taxes	251.3	259.2
Other	118.7	134.3
Other liabilities	\$ 794.9	\$ 828.7

Report of Independent Accountants

PricewaterhouseCoopers LLP

To the Shareholders and Board of Directors
of Kellogg Company

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of earnings, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Kellogg Company and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed in Note 1 to the financial statements, the Company changed its method of accounting for business process reengineering costs effective October 1, 1997.

Supplemental Financial Information

Quantitative & qualitative disclosures related to market risk sensitive instruments

The Company is exposed to certain market risks which exist as a part of its ongoing business operations and uses derivative financial and commodity instruments, where appropriate, to manage these risks. The Company, as a matter of policy, does not engage in trading or speculative transactions. Refer to Note 12 within Notes to Consolidated Financial Statements for further information on accounting policies related to derivative financial and commodity instruments.

Foreign exchange risk

The Company is exposed to fluctuations in foreign currency cash flows related to third party purchases, intercompany product shipments, and intercompany loans. The Company is also exposed to fluctuations in the value of foreign currency investments in subsidiaries and cash flows related to repatriation of these investments. Additionally, the Company is exposed to volatility in the translation of foreign currency earnings to U.S. Dollars. Primary exposures include the U.S. Dollar versus the British Pound, member currencies of the European Monetary Union, Australian Dollar, Canadian Dollar, and Mexican Peso, and in the case of inter-subsidiary transactions, the British Pound versus other European currencies. The Company assesses foreign currency risk based on transactional cash flows and enters into forward contracts and other commitments to sell foreign currency revenues, all of generally less than twelve months duration, to reduce fluctuations in net long or short currency positions. No borrowings were outstanding under commitments to sell foreign currency revenues at December 31, 1999 or 1998. As of December 31, 1999, the Company had committed to borrowings during 2000 in the cumulative principal amount of approximately \$366 million.

The tables below summarize forward contracts held at year-end 1999 and 1998. All contracts are valued in U.S. Dollars using year-end exchange rates, are hedges of anticipated transactions, and mature within one year.

Contracts to sell foreign currency

Currency sold	Currency received	Notional value (millions)		Exchange rate (fc/1US\$)		Fair value (millions)	
		1999	1998	1999	1998	1999	1998
Japanese Yen	U.S. Dollar	\$3.8	\$ —	102.12	—	\$ —	\$ —
Belgian Franc	British Pound	—	1.9	—	35.11	—	—
Swiss Franc	German Deutschmark	—	.3	—	2.08	—	—
Danish Kroner	British Pound	—	3.2	—	6.60	—	(.1)
French Franc	British Pound	—	6.9	—	5.69	—	(.1)
Irish Punt	British Pound	—	3.4	—	.68	—	—
Swedish Kroner	Danish Kroner	—	1.6	—	7.41	—	.1
Venezuelan Bolivar	U.S. Dollar	—	2.1	—	726.67	—	(.6)
Total		\$3.8	\$19.4			\$ —	(\$.7)

Contracts to purchase foreign currency

Currency purchased	Currency exchanged	Notional value (millions)		Exchange rate (fc/1US\$)		Fair value (millions)	
		1999	1998	1999	1998	1999	1998
German Deutschmark	British Pound	\$ —	\$2.8	—	1.69	\$ —	\$ —

PricewaterhouseCoopers LLP

Battle Creek, Michigan

January 27, 2000

Interest rate risk

The Company is exposed to interest rate volatility with regard to future issuances of fixed rate debt and existing issuances of variable rate debt. Primary exposures include movements in U.S. Treasury rates, London Interbank Offered rates (LIBOR), and commercial paper rates. The Company uses interest rate caps, and currency and interest rate swaps, including forward swaps, to reduce interest rate volatility and funding costs associated with certain debt issues, and to achieve a desired proportion of variable versus fixed rate debt, based on current and projected market conditions.

The tables below provide information on the Company's significant debt issues and related hedging instruments at year-end 1999 and 1998. For foreign currency-denominated debt, the information is presented in U.S. Dollar equivalents. Variable interest rates are based on effective rates or implied forward rates as of year-end 1999. Refer to Note 7 within Notes to Consolidated Financial Statements for further information.

Significant debt issues (millions)

Debt characteristics	Principal by year of maturity				12/31/99 Fair value	12/31/98 Fair value
	1999	2000	2001	2004 2005		
Euro Dollar			\$500.0		\$494.7	\$505.8
fixed rate			6.125%			
effective rate (a)			6.400%			
U.S. Dollar			\$400.0		\$397.1	\$435.9
fixed rate			5.75%			
effective rate (b)			5.23%			
Euro Dollar			\$500.0		\$488.9	\$510.2
fixed rate			6.625%			
effective rate (a)			6.354%			
U.S. Dollar			\$200.0		\$179.4	\$198.4
fixed rate			4.875%			
effective rate (a)			6.070%			
U.S. commercial paper	\$423.3	\$448.3			\$448.3	\$423.3
weighted avg. variable	5.2%	5.9%				
Multi-currency revolving credit facility	\$148.5	\$ 16.2			\$ 16.2	\$148.5
effective rate	5.5%	5.6%				

(a) Effective fixed interest rate paid, as a result of settlement of forward interest rate swap at date of debt issuance.

(b) Effective fixed interest rate paid, as a result of extendable feature. Refer to Note 7 within Notes to Consolidated Financial Statements for further information.

Interest rate swaps (millions)

Instrument characteristics	Notional amt.	Year of maturity	12/31/99 Fair value	12/31/98 Fair value
		2001		
Interest rate swap – pay variable/receive fixed – hedge of existing debt issue	Pay	6.15%	(\$1.1)	\$5.6
	Receive	6.40%		
Interest rate swap – pay variable/receive fixed – hedge of existing debt issue	Pay	4.72%	(\$3.2)	\$5.2
	Receive	5.23%		
Other swaps & caps disposed of in 1999			\$ —	\$1.3

Price risk

The Company is exposed to price fluctuations primarily as a result of anticipated purchases of raw and packaging materials. Primary exposures include corn, wheat, soybeans, soybean oil, sugar, and paperboard. The Company uses the combination of long cash positions with suppliers, and exchange-traded futures and option contracts to reduce price fluctuations in a desired percentage of forecasted purchases over a duration of generally less than one year. The fair values of commodity contracts held at year-end 1999 and 1998 were insignificant, and potential near-term changes in commodity prices were not expected to have a significant impact on the Company's future earnings or cash flows.

For all derivative financial and commodity instruments presented in the tables above, changes in fair values of these instruments and the resultant impact on the Company's cash flows and/or earnings would generally be offset by changes in values of underlying transactions and positions. Therefore, it should be noted that the exclusion of certain of the underlying exposures from the tables above may be a limitation in assessing the net market risk of the Company.

Products and Manufacturing Locations

Kellogg North America

Products

Kellogg's® cereals, croutons, breading and stuffing products

Eggo® waffles, pancakes, toaster muffins

Morningstar Farms®, *Loma Linda*™, *Natural Touch*®, *Worthington*® meat alternatives

Nutri-Grain®, *Rice Krispies Squares*®, *Rice Krispies Treats*®,
Nutri-Grain Twists™ cereal bars

Pop-Tarts® toaster pastries

Manufacturing Locations

San Jose, California

Atlanta, Georgia

Rome, Georgia*

Pikeville, Kentucky

Battle Creek, Michigan

Omaha, Nebraska

Blue Anchor, New Jersey

Worthington, Ohio

Zanesville, Ohio

London, Ontario

Lancaster, Pennsylvania

Muncy, Pennsylvania

Memphis, Tennessee

Rossville, Tennessee

Kellogg Europe

Products

Kellogg's® cereals, breading products, cereal bars

Nutri-Grain®, *Rice Krispies Squares*™, *Nutri-Grain Twists*™ cereal bars

Pop-Tarts® toaster pastries

Manufacturing Locations

Bremen, Germany

Manchester, Great Britain

Wrexham, Great Britain

Springs, South Africa

Valls, Spain

Kellogg Asia-Pacific

Products

Kellogg's®, *Cerola*®, *Day Dawn*® cereals

Nutri-Grain®, *Rice Bubbles Treats*™, *Rice Krispies Treats*™,
Coco Pops®, *K-time*™, *Day Dawn*® cereal bars

Pop-Tarts® toaster pastries

Komplete™ biscuits

Manufacturing Locations

Brisbane, Australia

Sydney, Australia

Guangzhou, China

Taloja, India

Takasaki, Japan

Bangi, Malaysia

Anseong, South Korea

Rayong, Thailand

Kellogg Latin America

Products

Kellogg's® cereals, breading products

Eggo® waffles

Nutri-Grain®, *Kuadri Krispis*® cereal bars

Pop-Tarts® toaster pastries

Keloketas™ cookies

Manufacturing Locations

Pilar, Argentina

Sao Paulo, Brazil

Bogota, Colombia

Guayaquil, Ecuador

Guatemala City, Guatemala

Linares, Mexico

Queretaro, Mexico

Maracay, Venezuela

*Effective January 2000



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Battle Creek, Michigan (E,C,F,S)

John L. Zabriskie

Chairman
NEN Life Science Products, Inc.
Boston, Massachusetts (C,F*)

A = Audit Committee

C = Compensation Committee

E = Executive Committee

F = Finance Committee

N = Nominating and Corporate Governance Committee

S = Social Responsibility Committee

*Committee Chairman

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President, Kellogg Europe

Janet L. Kelly •

Executive Vice President

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General Counsel and Secretary

Thomas J. Webb*•

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Chief Financial Officer

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Senior Vice President

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Corporate Affairs

Corporate Ethics Officer**

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Vice President

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Vice President

Tax, Internal Auditing, and Treasurer

Joseph J. Tubilewicz

Vice President

Worldwide Purchasing

*Effective January 2000

**Effective March 2000

• Member of Global Leadership Team

Board Members

Front, from left: William C. Richardson, Arnold G. Langbo, Carlos M. Gutierrez, William E. LaMothe, Gordon Gund. Back, from left: Benjamin S. Carson, M.D., Ann McLaughlin, Claudio X. Gonzalez, Dorothy A. Johnson, John L. Zabriskie, Harold A. Poling, Carleton S. Fiorina, J. Richard Munro. Below: William D. Perez, elected to the board in December 1999.



www.kelloggs.com



Kellogg's

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